Leicester
City Council

CABINET **19 JANUARY 2004**

FINANCE, RESOURCES AND EQUAL OPPORTUNITIES SCRUTINY COMMITTEE **22 JANUARY 2004**

COUNCIL **29 JANUARY 2004**

CORPORATE CAPITAL PROGRAMME 2004/05

Report of the Chief Finance Officer

1. Purpose of the report

1.1 This report recommends updating the "corporate" capital programme for 2004/05 and sets out the implications of the Prudential Framework for borrowing, which is effective from 1 April 2004.

2. Summary

2.1 The Council approved a Capital Strategy in January 2002. The Council subsequently set a 3-year capital programme based upon the priorities and policies set out in that strategy. The programme for 2004/05 is the final part of that 3 year programme: subsequent programmes will be based on a new capital strategy derived from the corporate plan.

2.2 From April 2004 the current system of capital controls will be replaced by the Prudential Framework for borrowing. The Prudential Framework will significantly change how authorities make capital investment decisions in the future and will be a key element in making decisions on the 3 year programme for 2005/06 to 2007/08. Nonetheless, as the Prudential Framework is in force from April 2004, some decisions need to be made in the current year.

2.3 In future local authorities will be free to borrow for capital investment providing the borrowing is "prudent, sustainable and affordable". The system is largely self-regulated and underpinned by regulation and guidance. The main requirement of the regulations will be the need for authorities to follow CIPFA's Code of Practice on Prudential Borrowing.

2.4 As part of setting the Council's General Fund revenue budget on 25 February, the Council will be asked to approve a set of prudential indicators which demonstrate that the council's borrowing decisions are "prudent, affordable and sustainable". A number of indicators applicable to capital spending decisions for the Housing Revenue Account are contained in the HRA budget report, elsewhere on your agenda for approval. This report sets out the background for the requirement on the Council to approve a set of indicators to underpin the requirements of the Prudential Framework. The indicators will not affect the Council's ability to complete the existing programme.

2.5 On 24 November Cabinet agreed to recommend to Council the completion of the current 3 year capital programme, which runs to 2004/05 and that a new capital strategy should be developed over the Spring of 2004, which will be used to develop a new 3-year corporate capital programme. The new strategy will be underpinned by the Council's new corporate plan.

2.6 The biggest area of risk in the approved capital programme is the Performing Arts Centre (PAC), for which provision of £4.4 million has been set aside. In March 2003 the funding strategy for the PAC was considered by Cabinet, (subsequently in September 2003, Cabinet agreed to proceed with the design stage of the PAC), and sources of funding amounting to £9.1million was identified as subject to moderate levels of risk or higher. To mitigate this risk, it was agreed that:-

(a) a £0.9 million contingency be maintained (subsequently increased when the reserve capital programme was deleted);
(b) some adjustment would be made to the 2004/05 capital programme if necessary, being
    - consideration in the last resort to changing the Council's commitment to certain rolling programmes,
    - removing the commitment to provide £750,000 and £100,000 to the housing and transport programmes respectively,
    - varying the 20% of sums notionally allocated for transport which are available for corporate priorities.
(c) other elements of this strategy included treating the PAC as a first call on the next 3 year capital programme.

The PAC is to be the subject of a report to Cabinet in February 2004.

"Service" Programmes

2.7 The majority of the Council's capital programme is funded from "service" resources. These are resources that are hypothecated to services by Central Government or local policy. Programmes funded from "service" resources are developed by the relevant corporate director with a recommended programme going to Cabinet via the relevant Scrutiny Committee for comment.

2.8 The most significant "service" programmes are housing, transport and education. The Housing programme will be considered by Housing Scrutiny on 15 January and Cabinet on 19 January, and will go to Council on 29 January for approval. Transport and Education programmes will be recommended to Cabinet in March.

3. Recommendations

3.1 The Finance, Resources and Equal Opportunities Scrutiny Committee is asked to give its comments on the draft programme to help inform Council on its decisions regarding the capital programme.

3.2 Cabinet is asked to:

i. recommend the development of a new capital strategy for the period 2005/06 to 2007/08;

ii. recommend the capital programme shown at Appendix 2 to Council, subject to any changes Council wishes to make pursuant to comments from Finance, Resources and Equal Opportunities Scrutiny Committee;

iii. designate the following as service resources for the purposes of this programme:-

- Housing capital receipts,
- 80% of Housing and 80% of the Transport maintenance elements of the Single Capital Pot.
- profits made by the Housing Maintenance DSO;
- the Education element of the Single Capital Pot other than formulaic allocations.

iv. recommend to Council the following status of the schemes in Appendix 2.

(a) Block A, being schemes which can proceed once the programme is approved, subject to compliance with Finance Procedure Rules;

(b) Block B, being schemes which can proceed subject to a decision relating to the Performing Arts Centre

(c) Block C being schemes that require further approval by Cabinet with regard to the detailed implementation of the scheme, to the extent that the further approval has not yet been obtained;

(d) Block D, being schemes that are subject to both further approval with regard to detailed implementation and a decision relating to Performing Arts Centre.

v the following addition to Financial Procedure note 5.3.4 in relation to "Spend to Save" schemes be referred to the Procedures Working Party prior to formal Council approval:

(a) bids to be funded by additional borrowing be approved by the Chief Finance Officer, in consultation with the Cabinet Link for Finance, for schemes up to a limit of £250,000,

(b) bids for schemes above £250,000 must be approved by Cabinet,

(c) the Chief Finance Officer be required to maintain a statement of rules for such spend to save schemes, the first such statement being at Appendix 2;

vi. note that as part of approving the 2004/05 General fund and HRA revenue budgets it will be asked to approve appropriate Prudential Indicators as set out in Appendix 3 to meet the requirements of the 2003 Local Government Act and CIPFA's Code of Practice on Prudential Borrowing;

vii. note that actual performance against the approved Prudential Indicators will be reported to members as part of the routine capital monitoring reporting process.

4. <u>Headline Legal and Financial Implications</u>

4.1 This report has been discussed with Peter Nicholls (Head of Legal Services) and there are no direct legal implications.

4.2 This report is exclusively concerned with financial issues.

5. Author

Nicola Harlow

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Mark Noble
Chief Finance Officer

<u>DECISION STATUS</u>

Key Decision	**Yes**
Reason	**Part of Budget and Policy Framework**
Appeared in Forward Plan	**Yes**
Executive or Council Decision	**Council**

Leicester City Council

CABINET — **14 JANUARY 2004**
FINANCE, RESOURCES AND EQUAL OPPORTUNITIES SCRUTINY COMMITTEE — **22 JANUARY 2004**
COUNCIL — **29 JANUARY 2004**

CORPORATE CAPITAL PROGRAMME 2004/05

Report of the Chief Finance Officer

SUPPORTING INFORMATION

1. Corporate Capital Programme

1.1 In November 2003, the Cabinet agreed to recommend to Council not to roll forward the current "corporate" capital programme beyond 2004/05 for several reasons.

1.2 From April 2004 the current system of capital controls will be replaced by the Prudential Framework for borrowing. The Prudential Framework will significantly change how authorities make capital investment decisions in the future. Local authorities will be free to borrow for capital investment providing the borrowing is "prudent, sustainable and affordable". The system is largely self-regulated and underpinned by regulation and guidance. The main requirement of the regulations will be the need for authorities to follow CIPFA's Code of Practice on Prudential Borrowing. Final regulations and CIPFA's Code of Practice have been issued.

1.3 Whilst the new system might, subject to "affordability, sustainability and prudence", enable the Council to address some of its capital aspirations and needs from 2004/05 there are risks attached to this approach. If the Council wishes to utilise any of the additional freedoms offered by the Prudential Framework it needs to be sure that it does so in respect of its highest priority schemes and needs. Whilst the use of additional flexibilities, such as unsupported borrowing, is not a one-off opportunity, clearly it is not an option which can be used with impunity and if it used early on to fund schemes without adequate consideration of all spending needs and priorities the wrong schemes may be funded. The Council's capital priorities are 2 years old and now need to be reconsidered in the light of the new corporate plan.

1.4 The Council is currently in the process of bidding to the Government's 'Building Schools for the Future' programme. If successful, the bid could attract around £150 million funding for Leicester's schools. The Council has also commenced an "Options Appraisal" on its housing stock, which will identify the most effective way of managing and funding the Council's housing stock in the future. These key pieces of work could have a significant impact on the Council's capital priorities in the future and, therefore, represent a further reason to complete the current 3 year capital programme and consider afresh the Council's capital programme, including the use of the Prudential Framework, from 2005/06 onwards.

1.5 For these reasons it is recommended that the Council develops a new medium term capital strategy, which can then be used as the basis of developing a new 3 year capital programme during 2004 for the period 2005/06 to 2007/08.

1.6 The Council will be formally invited to consider some limited use of the Prudential Framework for the property maintenance backlog and ICT infrastructure as part of the budget report to Council on 25 February, chiefly to address high priority property maintenance schemes.

1.7 The HRA capital programme report is elsewhere on the agenda. The report proposes Prudential Borrowing of £6 million in 2004/05 to support the programme to be used to move closer to the Decent Homes Standard.

2. Capital Strategy

2.1 In the past 2 years the Council has achieved a "good" rating for its capital strategy and therefore has not had to submit a capital strategy to government this year. Whilst not a government requirement, it is still good practice to have a capital strategy, especially in the context of the Prudential Framework, when a clear set of priorities and rules are essential for ensuring the Council makes proper decisions on capital. However, the format and content will no longer be steered by government, which means the Council has a free hand to determine a strategy that only contains those elements that are genuinely useful.

2.2 In order to develop a new capital programme in 2004 for the period 2005/06 to 2007/08 the Council should determine a new set of capital priorities based upon current priorities. Directors have started the process of considering their main service capital priorities which will flow from the Council's Corporate Plan.

3. Resources

3.1 Types of Capital Resources

3.1.1 The Council has determined 2 types of capital resource: "Service" resources and "Corporate" resources.

3.1.2 "Service" resources are those resources ring-fenced to a particular service or scheme by legislation, government or local policy.

3.1.3 "Corporate" resources are those resources that can be spent entirely at the Council's discretion. The Corporate capital programme is only concerned with schemes funded from "corporate" resources. Programmes funded from "Service" resources are recommended to Cabinet by the relevant Corporate Director after consultation with the relevant scrutiny committee.

3.1.4 The most significant "service" programmes are housing, transport and education. A proposed housing programme will be considered by Housing Scrutiny on 15 January and then to Cabinet on 19 January and Council on 29 January for approval. The transport and education programmes will be recommended to Cabinet in March.

3.2 "Corporate" Resources

3.2.1 All capital receipts, excluding Housing right to buy and other housing receipts, have been designated as "corporate" resources for the 2002/03 to 2004/05 capital programme. The other main "corporate" resource is contained within the Single Capital Pot (SCP).

3.2.2 The SCP gives authorities additional freedom to use previously “ring-fenced” resources for corporate schemes.

3.2.3 The SCP is a single allocation, in the form of a Basic Credit Approval, comprising elements for:-

Housing
Transport – allocation for maintenance
Transport – allocation for the Local Transport Plan “Package”
Education
Social Services

3.2.4 In principle the allocation is not hypothecated and can be spent on any projects that the Authority desires. However, in reality the additional freedom is restricted because the allocations of the main elements of the SCP, Education, Housing and Transport, are substantially based upon submissions made to Government. The Housing Investment Programme, Housing Business Plan, Local Transport Plan and submissions for Education set out investment needs and strategies to implement the overall aims of these strategies. Therefore, if significant amounts of the notional Education, Housing and Transport resources were spent on other services it is likely that this would be taken into account when future resources allocations to the Council are made.

3.2.5 It was agreed by the Council (when the 3 year Capital Programme was approved) that, in order to strike an appropriate balance between providing more freedom to the Council to determine its capital spending priorities, and ensuring that future resources allocations are not affected, 20% of the notional housing and 20% of the transport (highways maintenance) SCP allocation could be deemed “corporate” resources. The entirety of the transport “package” allocation was treated as a “service” resource. As part of the 2005/06 – 2007/08 capital programme process the Council will need to reconsider this policy to take account of further developments such as the role of Regional Housing Boards in the allocation of resources.

3.2.6 Those elements of the Education allocation awarded for specific purposes (£5.1m) have been hypothecated to Education, whereas the element allocated by formula (£0.5m) is treated as corporate. The DfES has reserve powers to ringfence all Education capital funding where an authority has an unsatisfactory asset management plan rating.

3.3 The Government’s Capital Settlement

3.3.1 In December the Government announced its capital settlement to Authorities for 2004/05. The government has announced a Single Capital Pot allocation for Leicester for 2004/05 of £23.598 million. This compares to an equivalent allocation in 2003/04 of £21.348 million, and represents an increase of 10% compared to the equivalent for last year. Whilst this is a significant increase this is largely due to the change in the allocation of resources for Education as explained below.

3.3.2 The Single Capital Pot allocation has been arrived at as follows.

Single Capital Pot	**2003/04 £000**	**2004/05 £000**	**% increase/ (decrease)**
Housing	8,604	7,138	
Housing Renewal	0	792	
Total Housing	8,604	7,930	(8)
Transport – Package	6,747	6,077	(10)

Transport – Maintenance	3,237	3,777	17
Social Services	185	195	5
Education	2,325	5,619	142
Other	282	0	(100)
Total service allocation	21,380	23,598	10
Discretionary Allocation			
Capital Strategy/AMP	100	0	
Service Assessments	619	0	
SCP before RTIA	22,099		
RTIA	(619)	0	
Total SCP	21,480	23,598	

3.3.3 Housing

The housing allocation has reduced by 8%. This is mainly due to reallocation of resources by Regional Housing Boards towards areas of growth identified by the Office of the Deputy Prime Minister, such as the South Midlands.

3.3.4 Transport

The allocation for transport has reduced by 10% in relation to package schemes and increased (by 17%) in relation Highway Maintenance. Overall there has been a small reduction (£130,000) in resources available.

In addition the Government has given provisional approval to a major maintenance scheme for the redevelopment of the Upperton Road viaduct at an estimated cost of £19.1 million.

3.3.5 Social Services

There has been a small increase of £10,000 in the allocation for Social Services.

3.3.6 Education

The increase in the Education element of the SCP relates to a change in the way Modernisation Funds have been allocated. In 2003/04 these resources were allocated partly as SCA and partly as grant, whereas in 2004/05 part of the allocation is within the SCP. A summary of all Education resources (not only those allocated as part of the SCP) for 2003/04 and 2004/05 is given below:

	2003/04 £000	2004/05 £000
Modernisation Fund / Condition Focused Capital	5,253	5,201
Schools Access Initiatives	588	549
Basic Need	1,489	2,127
Basic Need – formula		485
Expanding Popular Schools	248	
Seed Challenge	373	371
Devolved Formula	3,824	3,920
	11,775	12,653

There is an increase in the total resources allocated of approximately £900,000.

3.3.7 Other Services

There is no longer an allocation for Environmental, Protective and Cultural services.

3.3.8 Discretionary Allocation

The Government has removed the discretionary allocation from 2004/05. This is very disappointing, especially as the original intention was for the discretionary element to increase to 20% of the total allocation over time. The Council has made numerous representations to the government on this point.

3.3.9 RTIA

This was a deduction previously made by central government to reflect the capital receipts authorities actually received. Though the effect was neutral on a national basis, its abolition removed unnecessary complexity and perverse incentives, and was welcomed.

3.3.10 The SCP resources available as "corporate" resources are therefore as follows:-

Single Capital Pot Allocation	2004/05
	£000
Social Services	195
Education	485
Housing (20%)	1,428
Transport – maintenance (20%)	755
Total SCP allocation	2,863

3.4 Capital Receipts

3.4.1 Capital Receipts are the other main "corporate" resource available to fund the programme. The following capital receipts target was agreed when the 3-year corporate programme was agreed, after adjusting for the abolition of RTIA.

3.4.2 The capital receipts target for the 2 year period 2003/04 – 2004/05 is £15.4 million of which £7.5 million is expected in 2003/04. This includes sales of all properties except HRA capital receipts.

3.4.3 Following the notification of capital programme allocations for 2004/05 there is an expected balance of corporate resources available of £2.3 million.

3.5 Other Resources

3.5.1 An additional £1.6 million has been approved from European funding for the Braunstone Leisure Centre scheme. As this scheme is already fully financed this additional funding will be redirected towards other Council supported European scheme(s) with the decision made by the programme monitoring committee of the Government Office of the East Midlands.

4. Process for setting the "Corporate" programme

4.1 The "corporate" capital programme was established with reference to the Council's agreed capital strategy. The following is a brief description of the process that was followed to set the 3-year programme when the strategy was originally developed in 2001.

4.2 The Capital Strategy contains a 2-stage process for prioritising schemes against available resources.

4.3 Stage 1

4.3.1 The first stage involved sifting bids to ensure that they meet the stated capital priorities of the Council.

4.3.2 Cabinet recommended the following corporate priorities in July 2001:-

- Investment to deliver priorities in the Community Plan.
- Investment to facilitate Best Value in Council Services.
- Investment to facilitate the Council's four main resources strategies (Revenue and Capital Strategy, Asset Management Plan, HR Strategy and ICT Strategy).

4.3.3 As well as these corporate priorities a number of service priorities were also agreed.

4.4 Stage 2

4.4.1 The second stage of the prioritisation process involved ranking schemes according to a financial and qualitative assessment. The financial assessment includes consideration of risk, financial benefits, additional match funding generated and revenue affordability.

4.4.2 The qualitative assessment considered such factors as the statutory requirement for spending, further consideration against stated priorities, whether the scheme meets Government expectations, community impact and findings from public consultation.

5. Recommended Schemes

5.1 The programme recommended for approval by Council is shown at Appendix 2. Some schemes within the programme are subject to further approval by Cabinet with regard to their detailed implementation and these are identified. In addition, following consideration of a report by Cabinet in March 2003, and a further report in September 2003, a number of schemes are subject to a decision relating to funding of the Performing Arts Centre; these are also indicated.

5.2 Details of the schemes included in Appendix 2 are given below:

Cultural Quarter
This scheme involves the development of a Cultural Quarter in St George's south area of the city centre. It involves developments for the Performing Arts, Film, New Media, Visual Arts and provision of Cultural Industries workspaces, but phase 1 is primarily restricted to the performing Arts Centre and workspaces.

Bridge Refurbishment
This block sum will enable a programme of works to be developed in order to carry out urgent repairs and improvements to Council bridges.

Watercourses
This will enable urgent repairs and improvements to watercourses in the City.

Education Minor Works
This funds a rolling programme of minor works funding.

Elderly Persons Homes
By 2007 all Elderly Persons Homes will have to meet new registration standards. This provision will enable a programme of works to be undertaken to assist in making these standards.

Childrens Homes
This block sum ensures that standards continue to be met and necessary minor works can be carried out.

Social Care & Health ICT Investment
This will be used for investment in personal computers enabling the number of staff with access to appropriate information technology to increase.

Social Care and Health Minor Works
This will allow ongoing improvements to all sectors of Social Care and Health.

Housing
This allocation will enable further investment in the service, in effect increasing housing resources from 80% to 90.5% of the notional housing allocation.

Town Hall
This will enable the programme of works to continue in order to bring more of the Town Hall into operational use. A full report on this scheme is scheduled for Cabinet in the near future.

ICT Infrastructure
The demands placed on the Authority’s ICT network infrastructure are continually changing, primarily the need to respond to e-commerce and e-business.

Playground Improvements/Kickabout Areas
This block sum will enable a number of refurbishments to existing playgrounds and kickabout areas as well as allowing some scope for the creation of new kickabout areas.

Conservation and Heritage Initiatives
This scheme relates to improvements to buildings/sites in the St Georges area of the city.

Riverside
This block sum is to fund a range of environmental and regeneration improvements to the riverside.

Local Environmental Works
This scheme will enable a programme of local works to be developed, particularly to make the environment tidier and cleaner.

Disability Discrimination Act

There is a rolling programme of works to carry out adaptations to enable improved access to services for disabled service users.

Asset Management Plan

This will enable coordination of the Authorities requirements for investment in existing assets both in terms of maintenance and improvement of buildings and necessary investment in gathering information on the condition and suitability of the Councils land and buildings.

Neighbourhood Improvements

Originally set-aside to facilitate the "Revitalising Neighbourhoods" project, this sum will be used for improvements to services in neighbourhoods as members decide. A further report will be taken to Cabinet on proposed uses of this sum.

Highways Maintenance

This allocation will enable further investment in the service, in effect increasing transport maintenance resources from 80% to 82.7% of the national allocation for highways maintenance.

6. Contingency for Further Pressures

6.1 As identified in paragraph 3.4.3 there is a balance of capital programme resources available of approximately £2.3 million. This has been set aside as a contingency for the Performing Arts Centre scheme. Cabinet has agreed that development work for the new theatre can take place at risk, but a funding package needs to be in place prior to final decisions are made in February.

7. Prudential Framework

7.1 The Local Government Act received Royal Assent on 22nd September. It is supported by CIPFA's Code of Practice on Prudential Borrowing.

7.2 The Code of Practice sets out how authorities should operate the new system. The Code is underpinned by a set of indicators that will help demonstrate that borrowing decisions are "prudent, sustainable and affordable" Authorities are also encouraged to develop their own local indicators, which will provide a fuller guide to borrowing decisions at a local level.

7.3 The Chief Finance Officer will recommend an appropriate level of borrowing each year based upon an assessment of these indicators.

7.4 It is likely that the Secretary of State will have reserve powers to set national borrowing limits if required in the interest of the overall economic position. He also has the power to impose limits on any individual authority he deems to be borrowing more than it can afford. Whilst it is hoped that the powers will not be exercised regularly, they clearly cause a level of uncertainty.

8. Government Supported Borrowing

8.1 At present, the Council receives grant to meet the cost of repaying principal and making interest payments on capital expenditure funded by borrowing. The cost to the Government is limited by the fact that it approves the level of borrowing in the first place.

8.2 The Government will continue to provide support for capital investment, but only at present levels. Any use of the Prudential Framework to increase borrowing will therefore be met at our own expense.

8.3 It is expected that the majority of local authority investment will continue to be at levels supported by the Government – revenue budgets will not permit a huge increase in borrowing.

9. Unsupported Borrowing

9.1 Any additional borrowing over and above that supported and funded by the Government will fall directly to authorities to fund. There are 2 main ways of funding any additional borrowing. Firstly, by seeking to identify compensating savings or efficiencies to meet the additional principal and interest costs. Secondly, to increase Council Tax or housing rents (in the case of spending on Council housing) to cover additional borrowing costs, subject to affordability.

9.2 The Government considers that the affordability constraint will be the most effective barrier to authorities borrowing excessively.

10. Potential Benefits of the Prudential Framework

10.1 The Prudential Framework is welcome and should offer a number of investment opportunities and choices that are not available under the current system.

10.2 The Council has significant investment backlogs and service aspirations that require substantial capital investment; therefore, any additional options that can be considered to meet these needs are welcome. Realistically the Council will still be heavily reliant upon adequate Government support to meet its needs.

10.3 The Prudential Framework will offer 2 key benefits which can be utilised prior to 2005/06:

- The potential to carry out “spend to save” type schemes, where upfront capital investment will lead to ongoing revenue savings;
- Enabling previously excluded capital procurement options to be pursued.

These are explored further below.

10.3.1 <u>“Spend to Save” Schemes</u>

10.3.2 At present, if the Council identifies an opportunity to provide pump priming capital investment that will lead to future revenue savings it is constrained by the availability of capital resources. Subject to a robust business case being made, the Council will in future be able to borrow additional money to make the investment and repay principal and interest costs through the revenue savings accruing to the project.

10.3.3 Such an approach could, for example, be used to rationalise property or assets, whereby some upfront investment may be required in order to release a capital receipt, which could subsequently fund the upfront investment as part of budget planning.

10.3.4 A system of option appraisal is being developed that will test such schemes and ensure that they are robust and will deliver anticipated savings. Corporate Directors are being encouraged to identify such schemes. Appendix 2 recommends the specific rules that should apply to departments wishing to use unsupported borrowing to fund “spend to save” schemes.

10.4 Alternative Capital Procurement options

10.4.1 One of the prime reasons for the current capital regulations was to stop the previous practice of authorities acquiring capital assets through “off-balance sheet” finance. This is generally the practice of acquiring the use of a capital asset, and taking many of the benefits that would result from ownership, whilst paying for the asset over the period it is used. Such arrangements included deferred purchase agreements or long leases. The Local Government and Housing Act 1989 was specifically designed to prevent abuse of such schemes by local authorities; in doing so, however, the good was thrown out with the bad.

10.4.2 A key aspect of the current capital regulations is that such arrangements have to be accounted for as if they were capital acquisition (i.e. at the outset of the contract rather than over its duration). The major drawback to authorities of this requirement is in relation to long leases. In some cases such arrangements can provide good solutions, but cannot be accommodated under present legislation.

10.4.3 Whilst the Prudential Framework will still require the authority to account for these arrangements as if they were capital acquisitions (they will show as notional borrowing), the fact that the Council can set its own borrowing limit means that as long as we can afford to pay for the annual cost of such arrangements they are feasible.

10.4.4 The Prudential Framework also enable departments, as part of their revenue strategies, to identify additional capital investment provided they can find revenue savings to service the debt.

11. Housing Revenue Account

11.1 The HRA budget for 2004/05 proposes financing £6 million of unsupported borrowing to support the capital programme. Further details regarding this proposal are given in the Housing Capital Programme report elsewhere on the agenda.

12. Indicators

12.1 Authorities have to produce a number of Prudential Indicators (PI’s) that demonstrate that borrowing is “affordable, prudent and sustainable”.

12.2 A number of indicators are prescribed, with some indicators being historic measures and others being estimates for a 3 year period. Authorities are encouraged to develop their own local indicators, which reflect local circumstances.

The indicators fall into 3 main areas, which measure:-

- External debt
- Capital expenditure plans
- Treasury management

The proposed indicators are shown in Appendix 3. The name of the indicator is shown in bold and where it is a local indicator this is identified.

12.3 The purpose and fundamental objectives of the indicators is given below:-

(a) Affordability - To ensure that the level of investment in capital assets proposed is within sustainable limits by monitoring the ratio of capital financing costs as a proportion of total revenue costs. The impact of borrowing on Council Tax and level of rents will also be calculated, although in practice this measure is confused due to the complications of government grant. (To overcome this, local indicators are proposed – see below).

(b) Prudence – to ensure that the level of external debt is kept within levels that are reasonable and manageable and in line with the Councils treasury management policies and practices. The impact of any additional capital expenditure on the level of indebtedness of the Authority is calculated.

(c) Sustainability – to give assurance that the level of capital expenditure and external debt proposed will not cause budgetary problems to the Authority and that the level of variable rate debt which the Authority is exposed to is limited to an acceptable level.

12.4 Actual performance will be monitored against each of the PI's and reported to members as part of the routine capital monitoring reports.

12.5 The PI's relating to the HRA have been included in Appendix 3. (Formal approval for these is sought as part of a separate report on your agenda). The PI's relating to the General Fund will be formally approved as part of the budget report to Council on 25 February 2004.

13. Treasury Management

13.1 At present the Council has £250m of debt (compared to £1bn of assets), which is a result of previous capital programmes and spending decisions. The rules for managing the Council's debt and cashflows are complex and are set out in the Treasury Policy, approved by Council, and the Treasury Management Strategy, approved by Cabinet. The Policy, the Strategy and their operation is directed by legislation and professional guidance. The replacement of the existing capital regulations also applies to those aspects of legislation that relates to Treasury Management functions.

14. Financial and Legal Implications

14.1 See main report.

15. Other Implications

OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	NO	
Policy	YES	The programme has been formulated with reference to the approved capital strategy.
Sustainable and Environmental	NO	
Crime and Disorder	NO	
Human Rights Act	NO	
Elderly/People on Low Income	NO	

16. Background Papers – Local Government Act 1972

16.1 Council 30/1/02 – Corporate capital programme 2002/03 to 2004/05
Cabinet 27/7/02 – Capital Strategy 2002/03 to 2004/05
Cabinet 24 November Capital Programme Issues 2004/05 and the Prudential Framework

17. Consultations

17.1 All departments have been consulted on the programme.

18. Report Author

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Appendix 1

Recommended Rules for Spend to Save Schemes under the Prudential Borrowing Regime

There are three distinct types of potential spend to save schemes which have been identified, and the rules recommended for each are set out below.

General Rules for Spend to Save Proposals under Prudential Borrowing

It is recommended that: -

- It be assumed that any proposals under £20,000 can be financed from departmental revenue budgets, and prudential borrowing will not be permitted.
- All proposals of £20,000 or more should be submitted to the Chief Finance Officer through the Financial Strategy section.
- Bids between £20,000 and £250,000 to be approved by the Chief Finance Officer in consultation with the Cabinet Link Member for Finance. Such approvals would be reported to Cabinet as part of the capital monitoring process.
- Bids over £250,000 to be submitted to Cabinet for consideration.
- All bids are to include a risk analysis, which will be specified by the CFO.
- All approved schemes will pay interest at rates specified below (to be reviewed by the CFO from time to time).

Option 1 "Spend to Save"

This scenario may occur when capital investment would result in ongoing revenue savings or increased income. Interest only charges of 7.5% will be made (HRA schemes will need to follow separate, statutory requirements). Part year costs would be split pro-rata to the start of the quarter when the payment is made (7.5% equates approximately to the average cost of providing an annuity over a 25 year period).

Option 2 Temporary "Pump Priming"

In this scenario, money would be borrowed up front with a repayment of the whole amount expected within a short-period i.e. within 5 years. This scenario could include examples where a new property is acquired, which would then be ultimately financed by the sale of the existing property, though this could not occur until the new premises are fully occupied for service delivery reasons. This scenario might also cover examples where grant funding was guaranteed for a future year, but where departments would want to start spending earlier.

As long as any money is outstanding, interest of 6.1% will be charged, and principal repaid at a minimum of 4% per annum.

The borrowing would be subject to a robust business case being demonstrated including a risk analysis that satisfies the Chief Finance Officer that the proposed repayments can be relied upon, and an adequate contingency is in place.

Option 3 Internal “Payback Fund”

This scenario is similar to the current Payback Fund, although interest would need to be incorporated in the repayments, and a longer repayment period possibly up to 10 years could be considered, although shorter paybacks would be encouraged.

Interest would be charged at around 6.1% of the outstanding balance plus the agreed capital repayments. This would be expressed in the form of a fixed repayment schedule. The option for early repayment of the loan would normally be allowed subject to the agreement of the Chief Finance Officer. The capital repayment would be recharged to departments regardless of actual compensating savings being realised.

Once the rules have been agreed the CFO will issue full guidance, including the production of standard forms and risk assessments for departments to utilise.

APPENDIX 3

Recommended Prudential Indicators

This appendix shows the way in which the prudential indicators will be presented to the Council for approval. The Authorised Limit cannot be exceeded, all other indicators are estimates.

Affordability

1. The **actual ratio of financing costs to net revenue stream** for 2002/03 and estimates for the current year and for the period 2004/05 to 2006/07 are:

	2002/03 £000 Actual	2003/04 £000 Estimate	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Non- HRA					
HRA	27.8%	25.6%	20.2%	22.4%	24.1%
Total					

2. The **level of "unsupported" borrowing and the additional Council Tax arising from the Council's use of "unsupported" borrowing** based on Band D is as follows (**this is a local indicator**):

	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Historic unsupported borrowing brought forward			
New Unsupported borrowing			
Less Unsupported borrowing repaid			
Total Unsupported borrowing carried forward			

Band D impact (£)

3. The **level of "unsupported" borrowing** relating to the HRA is as follows (**this is a local indicator**):

	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Historic unsupported borrowing brought forward	0	6,000	11,880
New Unsupported borrowing	6,000	6,000	6,000
Less Unsupported borrowing repaid	0	(120)	(238)
Total Unsupported borrowing carried forward	6,000	11,880	17,642

4. The **estimated incremental impact on council tax and average weekly rents** of capital investment decisions proposed in the General Fund Budget and HRA Budget reports over and above capital investment decisions that have previously been taken by the council are:

	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Band D council tax (£xx.xx)			
HRA rent (£45.85)	£0.42	£0.85	£1.27

The total Band D Council Tax (City Council element) recommended in this budget report is £xx.xx and the average weekly rent recommended (approved) is £45.85

Prudence

5. The actual **capital expenditure incurred** in 2002/03 and estimates of capital expenditure to be incurred in the current financial year and for the period 2004/05 to 2006/07 (based upon the Council Capital Programme agreed by Council on 29th January) that are recommended are:

	2002/03 £000 Actual	2003/04 £000 Estimate	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Education					
Housing					
Transport					
Regeneration					
Other					
Total non- HRA					
HRA	20,304	19,397	27,161	25,365	25,720
Total					

6. **The Capital Financing Requirement** measures the authority's underlying need to borrow for a capital purpose. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from the capital spending. By contrast the Capital Financing Requirement reflects the authority's underlying need to borrow for capital purposes.

The actual capital financing requirement in 2002/03 and estimates of the capital financing requirement for the current financial year and for the period 2004/05 to 2006/07 (based upon the Council Capital Programme agreed by Council on 29th January) are:

	31/03/03 £000 Actual	31/03/04 £000 Estimate	31/03/05 £000 Estimate	31/03/06 £000 Estimate	31/03/07 £000 Estimate
Non- HRA					
HRA	173,922	162,240	168,049	174,049	180,049

7. The **Capital Financing requirement split between Unsupported and Supported borrowing** for the next 3 years is **(this is a local indicator):**

	2003/04 £000 Estimate	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
General Fund Capital Financing Requirement - Supported Borrowing		**TBC**		
General Fund Capital Financing Requirement – Current Unsupported Borrowing				
General Fund Capital Financing Requirement – New Unsupported borrowing.				
Total General Fund Capital Financing Requirement				

8. CIPFA's Prudential Code for Capital Finance specifies **the requirement that over the medium term net borrowing will only be for capital purposes**, and that authorities should ensure that net borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and next two financial years. The authority has met this requirement in 2003/04 and, based upon current capital commitments and proposals in this budget report, there are not anticipated to be any difficulty for the current or future years.

9. The following **Authorised Limits** for external debt, gross of investments, are recommended for the next 3 years. These limits separately identify borrowing from other long term liabilities, such as finance leases.

   The Authorised Limit is based on the Council's current commitments, as set out in the capital programme agreed by Council on 29 January and fully reflect the impact of proposals made in this budget setting report. The Authorised Limit is also consistent with the Council's approved treasury management policy statement and practices. The Council is also asked to delegate authority to the CFO, within the total Authorised Limit for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities. Any such changes will be reported to the Council meeting following the change.

   The estimates are based upon an estimate of the most likely, prudent but not worst case scenario and has been based upon standard risk management policies.

   The Authorised Limit contains headroom to enable self financing "spend to save" schemes to be undertaken, based upon a proven business case for investment being carried out and appropriate risk management strategies being in place. The Authorised Limit also includes sufficient headroom for the Council to enter other forms of credit arrangements, such as long term leases, subject to underlying revenue funding being in place to finance such arrangements, which according to general accounting practice must be shown as external borrowing.

In taking its decisions on this budget report, the Council is asked to note that the Authorised Limit determined for 2004/05 will be the statutory limit determined under section 3 (1) of the Local Government Act 2003.

	Actual External Debt as at 31 March 2004	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Borrowing required for government supported borrowing				
Other long term liabilities				
Unsupported Borrowing - HRA - General Fund				
“Spend to Save” headroom				
Cashflow/Refinancing headroom				
Total Authorised Limit				

10. The following **Operational Boundary** for external debt, gross of investments, are recommended for the next 3 years. These limits separately identify borrowing from other long term liabilities, such as finance leases. The proposed Operational Boundary for external debt is based upon the same estimates as the Authorised Limit but reflects directly the CFO’s estimate of the most likely, prudent but not worst case scenario, without additional headroom included within the Authorised Limit to allow for unusual cash movements and equates to the maximum external debt projected by this estimate. The Operational Boundary represents a key management tool for in year monitoring by the CFO.

The Council is also asked to delegate authority to the CFO, within the total Operational Boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities.

	2004/05 £000 Estimate	2005/06 £000 Estimate	2006/07 £000 Estimate
Borrowing required for government supported borrowing			
Other long term liabilities			
Unsupported Borrowing			
“Spend to Save” headroom			
Total Operational Boundary			

Sustainability

11. On 24 November the Council’s cabinet adopted CIPFA’s Code of Practice for Treasury Management in the Public Services. It is recommended that the Council sets an **upper limit on its fixed interest rate exposures** for the period 2004/05 to 2006/07 of 100% of its net outstanding principal sums.

12. It is further recommended that the Council sets an **upper limit on its variable interest rate** exposures for the period 2004/05 to 2006/07 of 40% of its net outstanding principal sums.

This means that the CFO will manage **fixed interest rate exposures** within a range of 60% to 100% and variable rate exposures within a range of 0 to 40%.

12. It is recommended that the Council sets upper and lower limits for the **maturity structure** of its borrowing as follows, where the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total borrowing that is fixed rate:

	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

13.1 The Council does not intend to invest cash sums for more than 364 days.