APPENDIX 2

PRUDENTIAL INDICATORS UPDATE – FOR 2007/08
(EXECUTIVE – 6 FEBRUARY 2007)

CAPITAL EXPENDITURE & EXTERNAL DEBT INDICATORS

1 Estimated Ratio of capital financing costs to the net Revenue Budget

The estimated ratios of financing costs to the net Revenue Budget for the current and future years, and the actual figure for 2005/06 are as follows:

Year	Executive 22/08/06		Update for 2007/08		
	Basis	**%**	**Basis**	%	**%**
2005/06	actual	4.4	actual	4.4	
2006/07	estimate	9.2	probable	8.7	
2007/08	estimate	9.5	estimate	9.1	
2008/09	estimate	9.7	estimate	9.3	
2009/10	estimate	na	estimate	9.3	

The estimates of financing costs include current Capital Plan commitments based on the latest Capital Plan, and are as reflected in the 2007/08 Revenue Budget and MTFS.

Comment

The figures from 2006/07 are significantly affected by the introduction of the new Dedicated Schools Grant from 1 April 2006. This change of funding mechanism by the Government has the effect of reducing the County Council's net Revenue Budget by around 50% which results in an effective doubling of this Indicator.

The updated estimates for 2006/07 to 2008/09 reflect a lower forecast of capital financing costs as a result of a range of factors, principally

(a) a lower forecast cost of borrowing
(b) a higher return on investments achieved (which is incorporated into the calculation)
(c) lower borrowing levels as a result of expenditure slippage in the Capital Plan and an updated forecast of Government Supported Borrowing approvals
(d) ongoing savings resulting from a number of debt re-scheduling exercises undertaken in 2006/07

APPENDIX A

<table>
<tr><th>Prudential Indicator</th><th>Comment</th></tr>
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2 Estimates of the incremental impact of capital investment decisions on the Council Tax

In considering its programme for future capital investment, the County Council is required within the Prudential Code to have regard to:

- ➔ affordability (eg implications for Council Tax)
- ➔ prudence and sustainability (eg implications for external borrowing)
- ➔ value for money (eg option appraisal)
- ➔ stewardship of assets (eg asset management planning)
- ➔ service objectives (eg strategic planning for the authority)
- ➔ practicality (eg achievability of the Capital Plan)

A key measure of affordability is the incremental impact on Council Tax. The County Council can consider different options for its capital investment programme based on their differential impact on the Council Tax.

The estimate of the incremental impact on Council Tax (at Band D) of past capital investment decisions which are reflected in the latest Capital Plan and also in the Revenue Budget for 2007/08, compared with the 2006/07 Council Tax are:

<table>
<tr><th rowspan="2">Year</th><th colspan="2">Executive 22/08/06</th><th colspan="2">Update for 2007/08</th></tr>
<tr><th>Basis</th><th>£ - p</th><th>Basis</th><th>£ - p</th></tr>
<tr><td>2007/08</td><td>estimate</td><td>+ 5.00</td><td>estimate</td><td>+1.21</td></tr>
<tr><td>2008/09</td><td>estimate</td><td>+ 6.28</td><td>estimate</td><td>+2.61</td></tr>
<tr><td>2009/10</td><td>estimate</td><td>na</td><td>estimate</td><td>+3.81</td></tr>
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This Indicator shows the incremental impact on Band D Council Tax of the capital financing costs resulting from unsupported prudential borrowing required to fund the forecast Capital Plan. This borrowing includes the funding shortfall of Capital Bids approved by Executive on 3 February 2004, as part of the 10 year Capital Forecast projection, together with a number of subsequent funding approvals. The 10 year Capital Forecast is due to be reviewed during the 2007/08 financial year using a new capital prioritisation methodology.

Debt charges resulting from Invest to Save schemes and certain other capital provisions are excluded however, as these are deemed to be self financed from within Directorate revenue budgets.

The updated figures are lower than previously reported as a result of

(i) lower capital financing costs as a result of capital expenditure slippage between years and reduced costs of borrowing together with savings from debt rescheduling

(ii) the 2007/08 figures are compared with 2006/07 Council Tax whereas the previous ones are compared with 2005/06 Council Tax levels.

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Prudential Indicator

3 Capital Expenditure - Actual and Forecasts

The actual capital expenditure that was incurred in 2005/06 and the estimates of capital expenditure to be incurred for the current and future years are:

Year	Executive 22/08/06		Update for 2007/08	
	Basis	£m	Basis	£m
2005/06	actual	81.5	actual	81.5
2006/07	estimate	88.6	probable	90.8
2007/08	estimate	118.1	estimate	109.4
2008/09	estimate	75.2	estimate	77.8
2009/10	estimate	n/a	estimate	63.7

The above estimates and those for certain other Prudential Indicators incorporate a number of figures that are based on:-

(i) the latest Capital Plan approved by Executive on 22 November 2006
(ii) expenditure on fixed assets funded directly from the Revenue Budget and not included in the Capital Plan
(iii) recently notified Highways LTP allocations for 2007/08 together with updated indicative figures for subsequent years
(iv) other known self funded variations
(v) identified expenditure slippage between years
(vi) various other refinements

Comment

The updated figures for 2006/07 to 2009/10 reflect the following significant variations compared with the figures submitted to Executive on 22 August 2006.

(a) expenditure slippage between years – self funded from grants/ contributions and new borrowing/capital receipts
(b) the Highways LTP settlement for 2007/08 announced in December 2006 together with some indicative allocations for subsequent years
(c) a number of variations self funded by Capital Grants and contributions, revenue contributions and earmarked capital receipts
(d) addition of a further year 2009/10 including bids approved in February 2004 as part of the 10 year capital forecast
(e) various other refinements

Prudential Indicator | **Comment**

4 Capital Financing Requirement and Forecast (CFR)

Actuals and estimates of the Capital Financing Requirement (CFR) at the defined year ends are as follows:

Date	Executive 22/08/06		Update for 2007/08	
	Basis	£m	Basis	£m
31 Mar 06	actual	281.2	actual	281.2
31 Mar 07	estimate	313.6	probable	317.5
31 Mar 08	estimate	346.6	estimate	345.4
31 Mar 09	estimate	364.6	estimate	363.0
31 Mar 10	estimate	n/a	estimate	386.2

The updated figures recommended for approval as part of the 2007/08 Budget process reflect the following main variations compared with the previous figures approved by the Executive on 22 August 2006.

(a) expenditure slippage between years that is funded from external borrowing
(b) capital receipts slippage between years that affects the year on year external borrowing requirements
(c) recently announced Highways LTP allocations for 2007/08 suggest a lower level of Government supported borrowed approvals in subsequent years
(d) addition of 2009/10 for forecast new borrowing approvals and Prudential Borrowing for bids previously agreed
(e) various other refinements

The CFR measures the underlying need for the County Council to borrow for capital purposes. In accordance with best professional practice, the County Council does not earmark borrowing to specific items or types of expenditure. The County Council has an integrated treasury management approach and has adopted the CIPFA Code of Practice for Treasury Management. The County Council has, at any point in time, a number of cashflows, both positive and negative, and manages its treasury position in terms of its overall borrowings and investments in accordance with its approved Annual Treasury Management Strategy. In day to day cash management, no distinction is made between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the County Council as a whole and not simply those arising from capital spending. In contrast, the CFR Indicator reflects the County Council's underlying need to borrow for capital purposes only.

CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following statement as a key definition of prudence:

"In order to ensure that, over the medium term, net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceeding year plus the estimates of any additional capital financing requirement for the current and the next two financial years."

The Corporate Director - Finance and Central Services has previously reported that the County Council had no difficulty meeting this requirement in 2005/06, nor are any difficulties envisaged for the current or future years of the Medium Term Financial Strategy. This opinion takes into account current spending commitments, existing and proposed Capital Plans, and the proposals in the separate Revenue 2007/08 Budget and Medium Term Financial Strategy report.

Prudential Indicator

5 Authorised Limit for External Debt

In respect of its external debt, it is recommended that the County Council approves the following Authorised Limits for its total external debt for the next three financial years.

The Prudential Code requires external borrowing and other long term liabilities to be identified separately. The figures shown below for the County Council however consist wholly of external debt with no other long term liabilities.

The authorised limit for 2007/08 will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

Year	Executive 22/08/06 Borrowing Limit £m	Update for 2007/08 Borrowing Limit £m
2006/07	343.9	349.0
2007/08	272.1	387.3
2008/09	405.4	400.2
2009/10	n/a	428.8

Comment

The Corporate Director - Finance and Central Services confirms that these authorised limits are consistent with the County Council's current commitments, existing Capital Plan, the proposals in the respective Revenue Budget and Capital Plan reports for future capital expenditure and financing, and with its approved Treasury Management Policy Statement.

The Corporate Director - Finance and Central Services also confirms that the limits are based on the estimate of most likely prudent, but not worst case, scenario with sufficient headroom over and above this to allow for operational issues (eg unusual cash movements). To derive these limits a risk analysis has been applied to the Capital Plan, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

The updated figures reflect a number of refinements which are common to the Capital Financing Requirement (see **Indicator 4** above) and Operational Boundary for External Debt (see **Indicator 6**). Explanations for these changes are provided under **Indicators 4 and 6** respectively.

Prudential Indicator	Comment

6 Operational Boundary for External Debt

It is recommended that the County Council approves the following Operational Boundary for external debt for the same period.

The proposed operational boundary for external debt is based on the same estimates as the Authorised Limit (ie **Indicator 5** above) but reflects an estimate of the most likely prudent, but not worst case, scenario without the additional headroom included within the Authorised Limit to allow for eg unusual cash flows.

Year	Executive 22/08/06 Borrowing Limit £m	Update for 2007/08 Borrowing Limit £m
2006/07	323.9	329.0
2007/08	352.1	367.3
2008/09	385.4	380.2
2009/10	n/a	408.8

The Operational Boundary represents a key management tool for the in year monitoring of external debt by the Corporate Director - Finance and Central Services.

The updated figures reflect refinements which are common to the Capital Financing Requirement (see **Indicator 4** above) together with

(i) loan repayment cover arrangements with the figures for 2007/08 and subsequent years being increased to reflect the opportunity for continuing significant debt rescheduling activities being undertaken in future years, and

(ii) relative levels of capital expenditure funded from internal cash balances rather than taking external debt.

These two financing transactions affect external debt levels at any one point of time during the financial year but do not impact on the Capital Financing requirement.

7 Actual External Debt

The County Council's actual external debt is set out below and consists wholly of external borrowing.

Year	Executive 22/08/06 £m		Update for 2007/08 £m	
31 Mar 2006	actual	274.4	actual	274.4

It should be noted that actual external debt is not directly comparable to the authorised limit (**Indicator 5 above**) and operational boundary (**Indicator 6 above**) since the actual external debt reflects a position at one point in time.

Prudential Indicator	Comment
TREASURY MANAGEMENT INDICATORS **8 Adoption of CIPFA Code of Practice for Treasury Management** The County Council formally adopted the CIPFA Code of Practice for Treasury Management in the Public Service at its meeting on 15 May 2002.	The County Council has fully complied with this Code following approval by Executive on 23 February 2004 of an updated Treasury Management Policy Statement incorporating 12 Treasury Management Practice statements.
9 Interest Rate Exposures It is recommended that the County Council sets upper and lower limits on its fixed and variable interest rate exposures as a percentage of outstanding principals sums for 2007/08, 2008/09 and 2009/10 as set out below - Lower % / Upper % Borrowing - Fixed 70 / 100 - Variable 0 / 30 Investments - Fixed 0 / 20 - Variable 80 / 100 Combined Net Borrowing and Investments - Fixed 0 / 130 - Variable -30 / 25	This means that the Corporate Director – Finance and Central Services, will for **borrowing** manage fixed interest rate exposure within the range 70% to 100% of outstanding principal and variable interest rate exposure within the range 0% to 30% of outstanding principal for **investments** will manage fixed interest rate exposure within the range 0% to 20% of outstanding principal and variable rate exposure within the range 80% to 100% of outstanding principal. The split of investments between fixed and variable rates is based on the market convention that investments up to 365 days are regarded as being at variable rates. The **combined net borrowing and investment** position represents the formal Prudential Indicator for Interest Rate Exposures. On its own however it does not show clearly how borrowing and investments will be managed, hence the two separate 'local indicators' shown above.

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<tr><th>Prudential Indicator</th><th>Comment</th></tr>
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10 Maturity Structure of Borrowing

It is recommended that the County Council sets upper and lower limits for the maturity structure of County Council borrowings as follows.

The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate:

<table>
<tr><th rowspan="2">Period</th><th rowspan="2">Lower Limit</th><th rowspan="2">Upper Limit %</th><th colspan="2">Memo item - actual at</th></tr>
<tr><th>1 April 05 %</th><th>1 April 06 %</th></tr>
<tr><td>under 12 months</td><td>0</td><td>50</td><td>2</td><td>2</td></tr>
<tr><td>12 months & within 24 months</td><td>0</td><td>15</td><td>2</td><td>2</td></tr>
<tr><td>24 months & within 5 years</td><td>0</td><td>45</td><td>9</td><td>17</td></tr>
<tr><td>5 years & within 10 years</td><td>0</td><td>75</td><td>18</td><td>15</td></tr>
<tr><td>10 years & above</td><td>20</td><td>100</td><td>69</td><td>64</td></tr>
<tr><td></td><td></td><td></td><td>100</td><td>100</td></tr>
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This Indicator has been marginally changed to provide increased borrowing flexibility and bring it into line with current practice adopted by many other local authorities. Previous lower limits for maturity periods 24 months to 10 years have been removed with the only lower limit (20%) being set for periods over 10 years. This reflects the movement away from short term borrowing which is currently more expensive, towards longer term borrowing. The lower limit of 20% for 10 years and above is designed to ensure that the County Council does not have the risk of having to repay all debt within a ten year period.

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Prudential Indicator	Comment
11 Total Principal Sums Invested for periods longer than 364 days A maximum of 20% of funds available for investment (both in house and externally managed) will be held in aggregate in ' non specified ' investments over 364 days. Based on estimated levels of funds and balances over the next three years, the need for liquidity and day to day cash flow requirements, it is forecast that £12m of the overall fund balances can be prudently committed to longer term investments over 364 days.	The maximum sum of £12m for investments longer than 364 days has been increased from £10m and the County Council has made two such investments to date in 2006/07 totalling £5m. Prior to 31 March 2004, Regulations generally prevented local authorities from investing for longer than 364 days. As a result of the new Prudential Regime however, these prescriptive regulations have been abolished and replaced with Government Guidance from April 2004. This Guidance gives authorities more freedom in their choice of investments (including investing for periods longer than 364 days) and recognises that a potentially higher return can be achieved by taking a higher risk. The new flexibility requires authorities to produce an Annual Investment Strategy that classifies investments as either **Specified** (liquid, secure, high credit rating & less than 365 days) or **Non Specified** (other investments of a higher risk). Non Specified investments are perfectly allowable but the criteria and risks involved must be vigorously assessed, including professional advice, where appropriate. Therefore investments for 364 days+ are now allowable as a Non Specified investment under Government Guidance. The use of such investments is therefore now incorporated into the County Council's Annual Treasury Management and Investment Strategy.