6. PRUDENTIAL CODE FOR CAPITAL FINANCE AND TREASURY MANAGEMENT POLICY (A1327/PN)

Purpose of the report

1. The purpose of this report is to approve the borrowing limits and prudential indicators set out below, together with the Treasury Management Policy Statement contained in the Appendix to this report.

Recommendations

2. **1. That the Authority adopts the Prudential Indicators and borrowing limits as described in the report, together with the policy on Minimum Revenue Provision in paragraphs 5.26 and 5.27.**
2. That the Authority approves the Treasury Management Policy Statement in Appendix 1.

3. That the Authority notes the changes arising from revisions to the Prudential Code and Treasury Management Code of Practice outlined in paragraph 5.22, and approves the amendments to Standing Orders Part 3 Financial Regulations Section K, and a revision to the remit of the Audit & Performance Committee within Part 4, as a result.

How does this contribute to our policies and legal obligations?

3. The Government introduced the Prudential Code in 2004-05 and this will be the seventh year of its operation. The Code was revised in 2009, although there are no significant changes for this Authority.

Background

4. The main benefit to the Authority is that there is no restriction on capital investment, subject to Government reserve powers to restrict borrowing for national economic reasons. To facilitate the decision making process and support capital investment decisions the Prudential Code requires the Authority to agree and monitor a number of prudential indicators. These indicators are mandatory, but can be supplemented with local indicators if this aids interpretation; no local indicators are currently used. The indicators cover affordability, prudence, capital expenditure, debt levels and treasury management.

Proposals

PRUDENTIAL CODE FOR CAPITAL FINANCE

5 This report is updated annually and contains revised estimates for the following three years together with actual figures when available.

6. **Actual and Estimate of Total Capital Expenditure to be incurred** – these figures represent best estimates based on the current stage of work on the Capital Strategy. As the title suggests, the figures include total expenditure on capital items, including assets financed from revenue, capital grants or use of capital receipts, as well as borrowing.

7. They include proposals which have already been approved by committee, plus an estimate of potential capital expenditure financed by the £70,000 sum set aside within the future revenue budget for debt repayment. This sum has not yet been allocated to

any specific capital project as this will depend on further development of the Capital Strategy, the respective priorities of any competing bids, subsequent settlement confirmations, and approval by Members. The substantial increase in expenditure in 2010/11 is the capital element of the Cycling Development project.

8.

	Actual 2008/09 £	Estimate 2009/10 £	Estimate 2010/11 £	Estimate 2011/12 £	Estimate 2012/13 £
Total Capital Expenditure	388,525	440,000	2,187,000	1,001,000	341,000

9. **Actual and Estimate of Capital Financing Requirement (C.F.R) –** The underlying need to borrow for capital purposes, after all other sources of capital financing available in each year are taken into account (i.e. after direct support of capital expenditure from revenue, capital grants or use of capital receipts).

10.

	Actual 2008/09 £	Estimate 2009/10 £	Estimate 2010/11 £	Estimate 2011/12 £	Estimate 2012/13 £
C.F.R	1,352,464	1,637,188	1,672,468	1,569,340	1,603,620

Affordability

11. **The ratio of financing costs to overall net revenue stream** – These indicators identify the proportion of financing costs measured against overall net revenue. Financing costs are the annual principal and interest payments on the estimated debt outstanding. Overall net revenue is the core National Park Grant.

12.

	Actual 2008/09 £	Estimate 2009/10 £	Estimate 2010/11 £	Estimate 2011/12 £	Estimate 2012/13 £
Borrowing Costs	47,688	155,763	196,777	247,516	253,330
Net Revenue	8,029,281	8,291,549	8,525,067	8,355,000	8,187,000
Percentage	0.59%	1.88%	2.31%	2.96%	3.09%

13. The amounts at these levels are considered to be affordable.

14. **Prudence**

15. **Net Borrowing and the Capital Financing Requirement** – This indicates the net long term debt outstanding for the Authority, after accounting for the availability of any temporary invested sums, in the previous, current and next three financial years.

16.

	Actual 2008/09 £	Estimate 2009/10 £	Estimate 2010/11 £	Estimate 2011/12 £	Estimate 2012/13 £
Capital Financing Requirement	1,352,464	1,637,188	1,672,468	1,569,340	1,603,620
Temporary investments	(3,160,582)	(3,000,000)	(3,000,000)	(2,500,000)	(2,000,000)
Net External Borrowing	(1,808,118)	(1,362,812)	(1,327,532)	(930,660)	(396,380)

17. The excess of investments over capital borrowing mainly reflect the quarterly claims of National Park Grant drawn down in advance of expenditure, to meet working capital needs. The level of borrowing is considered to be prudent.

18. **The Authorised Limit** – This represents the limit beyond which borrowing is prohibited, and needs to be set and revised if necessary by members. The calculation will be different in approach and outcome for all authorities. In the absence of any firm guidance it is recommended that the limit is set at the following levels to reflect the likely increase in debt arising from the Capital Financing Requirement, plus a margin to allow some flexibility within the estimated levels of capital expenditure.

19.

	2010/11 £m	**2011/12 £m**	**2012/13 £m**
Borrowing	1.9	1.9	1.9
Other Long Term Liabilities	NIL	NIL	NIL
Total	**1.9**	**1.9**	**1.9**

20. **The Operational Boundary** – This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year.

21.

	2010/11 £m	**2011/12 £m**	**2012/13 £m**
Borrowing	1.7	1.7	1.7
Other Long Term Liabilities	NIL	NIL	NIL
Total	**1.7**	**1.7**	**1.7**

22. **Actual External Debt** – This is actual borrowing plus actual other long-term liabilities at a certain point in time.

	Actual 2007/08 £	**Actual 2008/09 £**	**Estimate 2009/10 £**
External Debt	674,077	657,883	1,141,000

23. The Chief Finance Officer will monitor the application of these prudential indicators, as required by the Code, and will bring forward to the Authority any significant deviation. The CFO is required to bring a report specifically to the Authority if the Authorised Limit is likely to be breached, for the Authority to determine whether the limit should be raised, or whether alternative procedures to keep within the existing limit are appropriate.

TREASURY MANAGEMENT

24. **Adoption of the Treasury Management Code** – The first Prudential Code indicator for Treasury Management is the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code on Treasury Management which this report recommends. The Prudential Code also specifies a number of prudential indicators in respect of Treasury Management operations. The Authority's Treasury Management Strategy is attached at Appendix 1. It was first approved in 1998 and has been updated to reflect changes required by the introduction of the Prudential Code and the Local Government Act 2003. In 2009 the code was revised, taking account of the international banking crisis and bank failures in Iceland. In particular, the Authority is

recommended to adopt four key principles in the new code. It is suggested that is best achieved by the Authority agreeing to replace the current Section K ("Investments and Borrowing" paragraphs K1 and K2) of Part 3 of Standing Orders, Financial Regulations, with the following paragraphs:-

K. Treasury Management

K1 The Authority maintains a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and adopts suitable Treasury Management Practices, setting out the manner in which the organisation will manage and achieve those policies and objectives.

K2 The Authority receives reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, and an annual report after its close.

K3 The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Budget Monitoring Group, and for the execution and administration of treasury management decisions to its Chief Finance Officer, who will act in accordance with the organisation's policy statement and Treasury Management Practices, and CIPFA's Standard of Professional Practice on Treasury Management.

K4 The Authority nominates its Audit & Performance Committee to be responsible for ensuring effective scrutiny of the Treasury Management strategy and policies.

In terms of achieving K1 above, it is considered that adoption of Appendix 1 is sufficient. In respect of K2, CIPFA recommend that the Authority receive a mid-year report during the year. Because the Authority's Treasury Management practices are relatively modest in scale and prudent by virtue of its adopted policies, it is considered that this criterion can best be met by a mid-year report to the Budget Monitoring Group (in K3 above). If the Treasury Management approach was to change in its nature, the Authority will have to approve this change, and at that point this practice could be reviewed by Members. It is proposed that the annual report at the close of the year mentioned in K3 can be included within the Statement of Accounts report to the Authority in June. Section K4 requires the remit of the Audit & Performance Committee to be revised, in Part 4 of Standing Orders, to include this responsibility. It would be the prerogative of this committee to request any reports it chooses on the subject; as the Chair and Vice-Chair of this committee attend the Budget Monitoring Group they will be alerted to any issues at mid-year stage, which they may feel require a more formal committee report.

25. **Fixed and Variable Rate Exposures, Maturity Structures, Longer Term Investments** – The introduction of the Prudential Code saw the introduction of 4 new prudential indicators.

26. (i) **Interest Rate Exposures - Fixed Rate** – The Authority should set an upper limit on its fixed interest rate exposures for 2010/11, 2011/12 and 2012/13 of 100% of its net outstanding principal sums.

(ii) **Interest Rate Exposures – Variable Rates** – The Authority should set an upper limit on its variable rate interest rate exposures for 2010/11, 2011/12 and 2012/13 of 100% of its net outstanding principal sums.

(iii) **Maturity Structure of Borrowing – Upper and Lower Limits for Maturity Structure –** The Authority is likely to have most new debt at a maximum of 25 years, although in circumstances when the life of an asset is less the period may be shorter.

(iv) **Total Principal Sum Invested for Period Longer than 364 Days** There are no plans for the Authority to invest sums for periods longer than 364 days.

MINIMUM REVENUE PROVISION (M.R.P.)

27. The MRP is the amount Local Authorities are required to set aside each year from their revenue account, in order to ensure that provision is made annually for the repayment of outstanding loan principal as well as interest charges. The previous Regulation required a minimum of 4% of the Capital Financing Requirement at the start of the year to be set aside – which ensured repayment of the principal over a minimum of 25 years. In practice, this understated the amount required to be set aside where assets had shorter lives. Local Authorities are now allowed to set a provision which the Authority considers to be prudent, in line with new statutory guidance, and the full Authority is required to approve a Minimum Revenue Provision Policy Statement. The broad aim of this is to ensure that debt is repaid over a period reasonably commensurate with the period over which the capital expenditure provides benefits.

28. The Peak District National Park Authority in last year's report adopted the Asset Life Method, which ensures that the Minimum Revenue Provision is calculated based on the estimated useful life of the underlying asset. This method should help to ensure that budgetary provision for debt repayments is linked to the life of assets purchased, ensuring that funds are available for replacement of assets when the end of their useful life is reached.

CONCLUSION

29. As well as borrowing, the Authority retains the ability to finance its capital expenditure from a combination of use of capital receipts, capital grants from external bodies, and direct revenue contributions. Until the Capital Strategy is finalised, it is proposed that borrowing will be restricted to projects which are able to finance debt repayments from within existing resources, mainly spend-to-save projects, or from prudent estimates of external income arising from the investment.

30. For any extension of borrowing beyond this the Prudential Code requires that explicit regard must be taken of option appraisal, asset management planning, and strategic planning. The impact of capital expenditure and associated borrowing is spread over a number of years and therefore it is important to consider the effect of any proposals in both the medium and long term. This will be achieved through the further development of the Asset Management Plan and ICT strategy; reference to the Authority's overall strategic aims for all proposals, and for appraisal, the use of formal business cases and, where there is a mix of capital and revenue expenditure, the use of discounting techniques, principally net present value.

31. There are no major changes proposed in the approach to Treasury Management and it is the Chief Finance Officer's view that the current approach, in terms of its borrowing and investing practices, minimises risk to the Authority.

Are there any corporate implications members should be concerned about?

32. **Financial:** See 5 above

33. **Risk Management:** The Prudential Code indicators help to manage risks inherent in capital expenditure. The proposed Treasury Management Policy manages and minimises the risks inherent in the Authority's borrowing and investing activities.

34. **Sustainability:** The indicators include consideration of the sustainability of capital borrowing.

35. **Consultees**

Management Team; Democratic Services Manager

Background papers

Treasury Management in the Public Services – CIPFA 2009.
The Prudential Code for Capital Finance in Local Authorities – CIPFA 2009

Report Author, Job Title and Publication Date

Philip Naylor, Chief Finance Officer, 18 March 2010