PRUDENTIAL INDICATORS 2017/18 TO 2019/20

The following prudential indicators are recommended to the Council.

A. Prudential indicators for Affordability

In demonstrating the affordability of its capital investment plan the Council must:

- Determine the ratio of financing costs (e.g. capital repayments, interest payments, investment income) to net revenue stream for both the Housing Revenue Account (HRA) and non-HRA services for a 3 year period.
- Determine the incremental impact on the Council tax and housing rents (in both instances the scope for increases is governed by the Government's ability to limit council tax increases and the current restriction on council rents).

Indicator A1 sets out the ratio of financing costs to net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

A1: Prudential indicator – Estimates of the ratio of financing costs to net revenue stream 2017/18 to 2019/20

Indicator	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Non HRA	4.00%	5.09%	5.28%
HRA	13.40%	13.60%	13.80%

Indicators A2 and A3 set out the estimated incremental impact on both the levels of council tax (Band D equivalent) and housing rents of the recommended capital investment plans and funding proposals. The impact has been calculated using the latest projections on interest rates for both borrowing and investments. The impact does not take account of government support included for new borrowing within the formula spending share and housing subsidy.

A2: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the council tax 2017/18 to 2019/20

Indicator	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Additional annual Council Tax requirement	£2.09	£37.73	£43.31

A3: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the average weekly housing rents 2017/18 to 2019/20

Indicator	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Addition in average weekly housing rent	£3.38	£8.40	£10.48

B. Prudential indicators for Prudence

B1: Prudential indicator – Gross debt and the capital financing requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

The Director of Finance and IT reports that the Council had no difficulty meeting this requirement in 2016/17, nor is there any difficulties envisaged in future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy.

The table below shows the projected position from 31 March 2016.

Indicator	Estimate £'000
CFR at 31/3/16	327,980
Increase in 16/17	29,258
Increase in 17/18	46,959
Increase in 18/19	4,786
Total CFR	**408,984**
Gross Debt	**400,000**

C. Prudential indicator for Capital Expenditure

Elsewhere in this agenda is a recommendation for the capital investment plans for the Council over the next three years. Indicator C1 summarises the recommendations within that report. Indicator C2 sets out the estimates of the capital financing requirement over the same period.

C1: Prudential indicator – Estimates of total capital expenditure 2017/18 to 2019/20

Indicator	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Total Non HRA	53,940	16,744	15,021
Total HRA	13,500	6,500	1,714
Total Programme	67,440	23,244	16,735

In considering the capital investment plan the Council had regard to a number of key issues, namely:

- affordability, e.g. implications for council tax/housing rents
- prudence and sustainability, e.g. implications for external borrowing
- value for money, e.g. option appraisal
- stewardship of assets, e.g. asset management planning
- service objectives, e.g. strategic planning for the Council
- practicality, e.g. achievability of the forward plan.

C2: Prudential indicator – Estimates of capital financing requirement 2017/18 to 2019/20

Indicator	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
HRA	193,049	198,286	198,286
Non-HRA	211,148	210,697	208,377
Total	404,197	408,983	406,663

The estimates are based on the financing options included in the recommended capital investment programme. The estimates will not commit the Council to particular methods of funding – the actual funding of capital expenditure will be determined after the end of the relevant financial year.

The Council has a number of daily cashflows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with the approved treasury management strategy and practices. In day to day cash management no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. It is possible external debt could exceed the capital financing requirement in the short term.

D. Prudential indicators for External Debt

A number of prudential indicators are required in relation to external debt

D1: Prudential indicator – Authorised limit 2017/18 to 2019/20

Indicator	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Borrowing	988,521	910,521	918,521
Other Long Term Liabilities	800	600	400
Total	909,321	911,121	918,921

The authorised limit is the aggregate of gross borrowing (i.e. before investment) and other long term liabilities such as finance leases. In taking its decisions on the budget report the Council is asked to note that the authorised limit determined for 2017/18 in the above table is a statutory limit required to be determined by full Council under section 3(1) of the Local Government Act 2003.

The authorised limits are consistent with the Council's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Director of Finance and IT confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

D2: Prudential indicator – Operational boundary 2017/18 to 2019/20

Indicator	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Borrowing	858,521	863,521	868,521
Other Long Term Liabilities	800	600	400
Total	859,321	864,121	868,921

The operational boundary is based on the authorised limit but without the additional headroom. The operational boundary represents a key management tool for in-year monitoring by the Director of Finance and IT. As with the authorised limit figures for borrowing (gross) and other long term liabilities are separately identified.

The authorised limit and operational boundary separately identify borrowing from other long-term liabilities. It is recommended that Council delegate authority to the Director of Finance and IT, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the Council. Any such changes made will be reported to the Council at its next meeting following the change.

D3: Prudential indicator – HRA Limit on Indebtedness Under Self Financing

This is known as the Debt Cap and is the absolute level of debt permitted under Self Financing Regulations. The debt cap was set at £188.141m which means debt attributable to the HRA cannot exceed this figure. Agreement to increase the debt cap to borrow by £11.58m in 2015/16 was approved by the DCLG, giving a revised debt cap £199.721m. At 31 March 2016 the Council had total HRA borrowing of £160.9m and the figure will be the same as at 31 March 2017.

E. Prudential indicators for Treasury Management

A number of prudential indicators are required in respect of treasury management. The indicators are based on the Council's treasury management strategy and take into account the pre-existing structure of the Council's borrowing and investment portfolios.

E1: Prudential indicator – the Council has adopted the "CIPFA Code of Practice for Treasury Management in the Public Services" within its Financial Standing Orders.

The Council has adopted the code within the financial standing orders and monitors the treasury management function to ensure it continues to meet the specified requirements.

E2: Prudential indicators – Upper limits on interest rate exposure 2017/18 to 2019/20

Indicator	2017/18	2018/19	2019/20
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

This indicator specifies the limits on the proportion on the Council net outstanding principal sums (i.e. net of investments) with fixed interest payments and variable interest payments.

The upper limit of 100% is a consequence of the Council maintaining an investment portfolio. Indicator E2a exemplifies the indicator over borrowing and investment.

E2a: Prudential indicators (supplemental) – Upper limits on interest rate exposure 2017/18 to 2019/20

Indicator	2017/18	2018/19	2019/20
Upper limit on borrowing – fixed rate exposure	100%	100%	100%
Upper limit on borrowing – variable rate exposure	50%	50%	50%
Upper limit on investments – fixed rate exposure	100%	100%	100%
Upper limit on investments – variable rate exposure	50%	50%	50%

Indicator E2a is supplemental to Indicator E2 and shows separately the maximum limits for both borrowing and investments. The indicator is not a requirement of the prudential code but it does show more clearly the interest rate exposure limits within which borrowing and investments will be managed.

E3`; Prudential indicator – Upper and lower limits on the maturity structure of borrowing 2017/18

	Upper Limit	Lower Limit
under 12 months	100%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	60%	0%
10 years and within 20 years	60%	0%
20 years and within 30 years	60%	0%
30 years and within 40 years	60%	0%
40 years and within 50 years	100%	0%
50 years and above	100%	0%

The limits in Indicator E3 represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period.

E4: Prudential indicator – Principle sums invested for periods longer than 364 days

Indicator	2017/18 £'000	2018/19 £'000	2019/20 £'000
Limit	450,000	450,000	450,000

This is the limit that the Council can have in investments that are for greater than one year. The council will have £65m as at 31 March 2017 and this provides headroom for further investments should opportunities arise.

E5: Prudential indicator – Credit Risk:

The Council employs Treasury advisors (Arlingclose) who provide monthly updates that consider security, liquidity and yield in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but, they are not a sole feature in the Council's assessment of counterparty credit risk The Council also considers alternative assessments of credit strength and information on corporate developments and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum BBB- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);

- Share prices (where available);
- Economic fundamentals, such as country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, market sentiment and momentum; and
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. All other indicators of creditworthiness are considered in relative rather than absolute terms

Approved Investment Counterparties:

Credit Rating	Banks/Building Societies Unsecured		Bank/Building Societies Secured		Government		Corporates		Registered Providers	
	Amount	Period	Amount	Period	Amount	Period	Amount	Period	Amount	Period
UK Govt	N/A	N/A	N/A	N/A	£unlimited	50 years	N/A	N/A	N/A	N/A
AAA	£10m	5 years	£20m	20 years	£20m	50 years	£10m	20 years	£10m	20 years
AA+	£10m	5 years	£20m	10 years	£20m	25 years	£10m	10 years	£10m	10 years
AA	£10m	4 years	£20m	5 years	£20m	15 years	£10m	5 years	£10m	10 years
AA-	£10m	3 years	£20m	4 years	£20m	10 years	£10m	4 years	£10m	10 years
A+	£10m	2 years	£20m	3 years	£10m	5 years	£10m	3 years	£10m	5 years
A	£10m	1 year	£20m	2 years	£10m	5 years	£10m	2 years	£10m	5 years
A-	£7.5m	13 months	£15m	13 months	£10m	5 years	£10m	13 months	£10m	5 years
BBB+	£5m	6 months	£10m	6 months	£5m	2 years	£5m	6 months	£5m	2 years
BBB	£5m	100 days	£10m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
BBB-	£5m	100 days	£10m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
None	£5m	6 months	N/A	N/A	£5m	25 years	N/A	N/A	N/A	N/A

Pooled Funds ,External Fund Managers and any other investment vehicle approved by the Section 151 Officer – Decisions are based on each individual case following appropriate due diligence work being undertaken

.

The above limits are the maximum that the Council would expect to have in place at any time. However, in practice the actual duration limits in place are continually assessed in conjunction with Arlingclose and are often much shorter than the limits in the above table.

Credit ratings: Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks and Building Societies Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Banks and Building Societies Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements. These investments are secured on the bank's assets, which limits the potential loss in the unlikely event of insolvency and means that they are exempt from bail-in. Where there is no investment specific credit rating, but, the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multi development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency. Investments with the UK Central government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but, are exposed to the risk of the company going insolvent.

Other Organisations – The Council may also invest cash with other organisations, for example making loans to small businesses as part of a diversified pool in order to spread the risk widely. Because of the higher perceived risk of unrated businesses such investments may provide considerably higher rates of return.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Community Agency and as providers of public services they retain a high likelihood of receiving Government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks coupled with the services of a professional fund manager in return for a fee. Money market funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but, are more volatile in the short term. These allow authorities to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds have no defined maturity date but are available for withdrawal after a notice period. As a result their performance and continued suitability in meeting the authority's investment objectives will be monitored regularly and decisions made on entering such funds will be made on an individual basis.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the authorities' treasury advisers who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made
- Any existing investment that can be recalled or sold at no cost will be, and
- Full consideration will be given to the recall or sale of all other investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade so that it may fall below the approved rating criteria then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but, can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the authorities cash balances then the surplus will be deposited with the UK Government via the Debt Management Office or invested in treasury bills for example or with other local authorities. This will cause a reduction in the level of investment income earned, but, will protect the principal sum.

Specified Investments

Specified investments will be those that meet the criteria in the CLG Guidance, i.e. the investment:

- is sterling denominated;
- has a maximum maturity of one year;
- meets the ''high credit quality'' as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council; and
- The making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

The Council defines 'high credit quality' organisations and securities as those having a credit rating of BBB- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds 'high credit quality is defined as those having a credit rating of A- or higher

Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares

Non-Specified Investment Limits

	Cash Limit
Total Long Term Investments	£450m
Total Investments without credit ratings or rated below A- with appropriate due diligence having been performed	£70m
Total Investments in foreign countries rated below AA+	£30m
Maximum total non-specified investments	£550m

Investment Limits

The maximum that will be lent to any one organisation in the Approved Investment Counter Party list (except the UK Government) is £20m.For other investments approved by the Section 151 Officer the amount to be invested will be determined by the Section 151 Officer, taking into account the relevant merits of the transaction such as duration, risk etc following due diligence work undertaken. A group of banks under the same ownership, a group of funds under the same management, brokers nominee accounts, foreign countries and industry sectors will all have limits placed on them as in the table below:

	Cash Limit
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£40m
Any group of pooled funds under the same management	£50m
Any external Fund Manager	£425m
Negotiable instruments held in a brokers nominee account	£20m
Foreign countries (total per country)	£30m
Registered Providers in total	£30m
Building Societies in total (excluding overnight investments)	£40m
Loans to small businesses	£20m
Money Market Funds	£40m
Investments approved by the Section 151 Officer	Reviewed for each case

Liquidity Management

The Council maintains a cash flow spreadsheet that forecasts the Council's cash flows into the future. This is used to determine the maximum period for which funds may be prudently committed. The forecast is compiled on a pessimistic basis, with receipts under estimated and payments over estimated to minimise the risk of the Council having to borrow on unfavourable terms to meet its financial commitments.