Attachment D - Appendix 4

FOREST HEATH DISTRICT COUNCIL
PRUDENTIAL INDICATORS & MRP POLICY 2018/2019

1. Background

1.1 Each year the Council sets an annual budget, which details the revenue and capital resources required to meet its priorities for service delivery. Under the provisions of The Local Government Act 2003, local authorities are able to make their own decisions about capital expenditure plans providing they assess the financing of this to be affordable, prudent and sustainable. The Council must also ensure treasury management decisions are made in accordance with good professional practice and understanding the risks involved while managing the risks to levels acceptable by the Council. In addition to complying with the Act they must comply with:

a. the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003; and

b. the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Prudential Code for Capital Finance in Local Authorities.

1.2 The Prudential Code was developed by the Chartered Institute of Public Finance and Accounting (CIPFA) to assist local authorities in taking their decisions.

1.3 The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. The Secretary of State has issued guidance on Minimum Revenue Provision and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

2. Objectives

2.1 The key objectives are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

2.2 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.

2.3 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets the indicators that must be used, and the factors that must be taken into account.

2.4 These targets are known as the "Prudential Indicators" and particular indicators will be used to separately assess:

- Capital Expenditure
- External Debt
- Affordability
- Treasury Management

Process and Governance

2.5 The Prudential Code sets out a clear governance procedure for the setting and revising of a capital strategy and prudential indicators. This is done by the same body that takes the decisions for the local authority's budget – Full Council. The chief finance officer, the Assistant Director (Resources and Performance), is responsible for ensuring that all matters required to be taken into account are reported to full Council for consideration, and for establishing procedures to monitor performance.

2.6 In setting the indicators due regard was paid to the following matters:

- service objectives, eg strategic planning for the authority
- stewardship of assets, eg asset management planning
- value for money, eg option appraisal
- prudence and sustainability, eg risk, implications for external debt and whole life costing
- affordability, eg implications for council tax/district rates
- practicality, eg achievability of the forward plan.

2.7 Set out below are the indicators for 2017/2018 and beyond. For each indicator, the CIPFA requirements of the code are set out in bold italics. An explanation is provided, unless the indicator and limits are completely self explanatory.

2.8 The figures used to compile the indicators which are detailed in this report are based on the latest five year capital programme and medium term financial strategy (MTFS).

3 Capital Strategy

3.1 In accordance with the CIPFA Prudential Code 2017 and in order to demonstrate the Council takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability the Council has in place a capital strategy that sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

4 Prudential Indicators 2017/18 – 2020/21

CAPITAL EXPENDITURE

Estimates of Capital Expenditure & Actual Capital Expenditure 2016/17

4.1 **The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators shall be referred to as:**

'Estimate of total capital expenditure to be incurred in years 1, 2 and 3.'

4.2 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable and affordable limits.

Capital Expenditure						
Indicator	**2016/17 £000 ACTUAL**	**2017/18 £000 Approved**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
Capital Expenditure	**20,972**	**19,807**	**5,236**	**41,490**	**11,643**	**1,379**

Financed by:	**2016/17 £000 ACTUAL**	**2017/18 £000 Approved**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
Capital Receipts *	14,005	1,066	145	1,176	220	220
Grants & Contributions	4,238	175	497	5,425	175	175
Revenue Reserves	439	3,676	3,676	5,824	305	984
Unfinanced - Borrowing *	2,290	12,590	918	29,065	10,493	0
Total	**20,972**	**19,807**	**5,236**	**41,490**	**11,643**	**1,379**

*These figures may decrease/increase if the S151 Officer uses her delegated authority under the MRP Policy to use greater amounts of usable capital receipts instead of borrowing. The total capital expenditure will remain the same.

Estimates of Capital Financing Requirement (CFR) & Actual CFR 2016/17

4.3 ***The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators shall be referred to as:***

'Estimate of capital financing requirement as at the end of years 1, 2 and 3'

4.4 The capital financing requirement can simply be understood as the Council's underlying need to borrow money long term. It does not necessarily mean that borrowing will be undertaken. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing. It is an aggregation of the amounts shown for Investment Property, Non-Current and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account and any other balances treated as capital expenditure. The indicator takes account of the borrowing requirement and the minimum revenue provision.

Capital Financing Requirement						
Indicator	**2016/17 £000 ACTUAL**	**2017/18 £000 Approved**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
CFR *	**5,291**	**25,198**	**5,443**	**33,350**	**42,894**	**41,228**

*These figures may increase/decrease if the S151 Officer uses her delegated authority under the MRP Policy to use greater amounts of usable capital receipts instead of borrowing. The total capital expenditure will remain the same.

4.5 The forecast capital financing requirement reflects the changes to the overall capital programme, including pending projects.

EXTERNAL DEBT

Authorised Limit

4.6 ***The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total gross external debt, separately identifying borrowing from other long term liabilities. This prudential indicator shall be referred to as:***

Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long term liabilities for years 1, 2 and 3.'

4.7 This limit represents the maximum amount the Council may borrow at any point in the year. It has to be at a level the Council considers is 'prudent'. It is ultra vires to exceed the authorised limit, and therefore the limits are set so as to avoid circumstances in which the Council would need to borrow more money than this limit.

4.8 It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

4.9 Other long term liabilities include items that would appear on the balance sheet of the Council that are related to borrowing. For example, the capital cost of leases would be included.

Authorised Limit of External Debt					
Indicator	**2017/18 £000 Approved**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
Authorised Limit	**28,947**	**6,578**	**38,872**	**51,031**	**51,031**

Operational Boundary

4.10 ***The local authority will also set for the forthcoming financial year and the following two years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long term liabilities. This prudential indictor shall be referred to as the:***

Operational Boundary = operational boundary for borrowing + operational boundary for other long term liabilities for years 1, 2 and 3'

4.11 The operational boundary is a measure of the most money the Council would normally borrow at any time during the year. The code recognises that circumstances might arise when the boundary might be exceeded temporarily, but suggest a sustained or regular pattern of borrowing above this level ought to be investigated, as a potential symptom of a more serious financial problem. Any movement between these separate limits will be reported to the next available Council.

Operational Boundary for External Debt					
Indicator	**2017/18 £000 Approved**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
Operational Boundary	**26,053**	**5,920**	**34,985**	**45,928**	**45,928**

Actual External Debt

4.12 The Council's actual external debt, borrowings, at 31 December 2018 was **£4,000,000**. There were no other long term liabilities.

Gross Debt and the Capital Financing Requirement

4.13 ***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 capital financing requirement in the preceding year plus the 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. This is a key indicator of prudence. This prudential indicator will be referred to as:

'<u>Gross debt and the capital financing requirement for years 1, 2 and 3.</u>'

Gross Debt and the Capital Financing Requirement					
Indicator	**2016/17 £000 ACTUAL**	**2017/18 £000 Revised**	**2018/19 £000 Estimate**	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**
Gross Debt*	4,000	4,918	33,983	44,926	44,926
Cumulative CFR**	4,000	7,019	36,084	47,027	47,027
Medium Term Debt not for Capital Purposes***	**0**	**-2,101**	**-2,101**	**-2,101**	**-2,101**

* Gross medium/long term debt only – excludes short term £1m overdraft facility

** Cumulative increase in CFR is CFR minus cumulative MRP reductions & negative opening balance

*** Negative balances illustrate internally borrowed funds

4.14 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.

<u>AFFORDABILITY</u>

4.15 The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits

4.16 In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it/estimated for the future, together with the totality of its capital plans, income and expenditure forecasts.

<u>Estimates of financing costs to net revenue stream & Actual financing costs to net revenue stream 2016/17</u>

4.17 ***The local authority will estimate for the forthcoming financial year and following two financial years the proportion of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of the proportion of financing costs to net revenue stream and shall be expressed in the following manner:***

<u>Estimate of financing costs ÷ estimate of net revenue stream x 100%</u>

4.18 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs

Financing Costs to Net Revenue Stream						
Indicator	**2016/17 ACTUAL**	**2017/18 Approved**	**2017/18 Revised**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Ratio %	1	14	14	23	34	47

4.19 In circumstances where interest costs on borrowing are greatly exceeded by interest and investment income the ratio of financing costs to the net revenue stream will be negative. This reflects the fact that the authority is making a contribution to the income and expenditure account via its investment income stream.

TREASURY MANAGEMENT

4.20 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Treasury Management Practices (TMPs) have been established by the Assistant Director (Resources and Performance) and are kept up to date.

Interest Rate Exposure

4.21 ***The local authority will set, for the forthcoming year and the following two years, upper limits to its exposures to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and will be referred to respectively as the upper limits on fixed and variable interest rate exposures.***

Upper limits on fixed and variable rate exposures

4.22 These two indicators on the following page, allow the Council to manage the extent to which it is exposed to changes in interest rates. Such decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's Treasury Management Strategy. In circumstances where interest costs on borrowing are greatly exceeded by interest and investment income the upper limit for fixed and variable interest rate exposure will be negative.

Upper Limit for Fixed and Variable Rate Exposure					
Indicator	**2017/18 Approved**	**2017/18 Revised**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
Upper Limit for Fixed Interest Rate Exposure (as a % of total investments)	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure (as a % of total investments)	60%	60%	60%	60%	60%

4.23 The upper limits on interest rate exposures can be expressed either as absolute amounts or as percentages.

Prudential limits for the maturity structure of borrowing

4.24 The local authority will set for the forthcoming year both upper and lower limits with respect to the maturity structure of its borrowing, calculated as follows:

- Amount of projected borrowing that is fixed rate maturing in each period

4.25 ***Expressed as a Percentage of total projected borrowing that is fixed rate at the start of the period where the periods in question are:***

- ***Under 12 months.***
- ***12 months and within 24 months.***
- ***24 months and within 5 years.***
- ***5 years and within 10 years.***
- ***10 years+***

4.26 All Councils undertaking borrowing need to ensure that the maturity structure of its borrowing is both prudent and affordable. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates, and is designed to protect against excessive exposure to interest rate changes in any one period, in particular in the course of the next ten years.

4.27 The proposed prudential limits are as follows:

Period (years)	Lower Limit	Upper Limit
Under 12 months	0%	20%
1 – 2 years	0%	20%
2 – 5 years	0%	20%
5 – 10 years	0%	20%
Over 10 years	0%	100%

4.28 The profiled limits set out above apply to the start of each financial year within the period 2017/18 to 2020/21

Total Principal Sums invested for longer than 364 days

4.29 ***Where a local authority invests, or plans to invest, for periods longer than 364 days, the local authority will set an upper limit for each financial year period for the maturing of such investments. The prudential indicators will be referred to as prudential limits for principal sums invested for periods longer than 364 days.***

Period (years)	Upper limit £m
31/3/2016	20
31/3/2017	20
31/3/2018	20
31/3/2019	20
31/3/2020	20
31/3/2021	20

5 Minimum Revenue Policy – Annual Policy Statement

5.1 This system for establishing the Minimum Revenue Provision has been radically revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414], ("the 2008 Regulations") in conjunction with the publication by the Department for Communities and Local Government of detailed MRP guidance.

5.2 All Local Authorities are required to establish annually their policy regarding Minimum Revenue Provision for the forthcoming year.

5.3 This is the limit on the statutory requirements for MRP. However, the requirements are supported by Guidance on Minimum Revenue Provision, issued by the Department for Communities and Local Government in February 2012. The status of the Guidance is established by section 21(1B) of the Local Government Act 2003: a local authority must have regard to guidance issued by the Secretary of State about accounting practices.

5.4 This is normally taken to mean guidance must be considered when taking accounting decisions but can be disregarded where an authority can make a reasonable case for doing so. The onus is on the authority to demonstrate that it can better meet its statutory duties by acting differently.

5.5 For MRP, this sets up a situation where an authority has a basic duty to determine a prudent level for MRP each year and is not constrained in the methodology that it applies. However, where this methodology is different from that recommended in the Guidance, the authority must be able to demonstrate that the outcome is as prudent as would have been arrived at applying the Guidance:

Method	Explanation
Supported debt	
Option 1	MRP is equal to the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations, as if they had not been revoked by the 2008 Regulations.
Option 2	**The CFR method** MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.
Unsupported debt	
Option 3	Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset.
a)	**Equal instalment method** MRP is the amount given by the following formula: (Capital expenditure in respect of the asset less total provision made before the current financial year), divided by the estimated life of the asset.
b)	**Annuity Method** MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing or credit arrangements.
Option 4	**Depreciation method** Charging MRP in accordance with the standard rules for depreciation accounting. (If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.)

5.6 It is proposed that the Minimum Revenue Provision Policy Statement for Forest Heath District Council is set as follows for 2018/2019.

Application of capital receipts or other sources

- The DCLG Guidance only applies to expenditure that has not been financed from other sources, primarily capital receipts and grant funding. Where the Council has usable capital receipts that are not needed for other purposes in that year, it can at the discretion of the section151 officer to apply where prudent to do so some or all of it to meet capital expenditure incurred in the current year or previous years under paragraph 23 of the 2003 Regulations to reduce or eliminate any MRP that might need to be set aside.

Loans

- In circumstances where a loan to a third party to fund capital expenditure is secured and there is no risk of default, the Council will not charge MRP because the principal sum of such a loan will have no consequences for the Council's revenue expenditure and it would be over-prudent to provide for the loan[1].

- In circumstances where a loan to a third party to fund capital expenditure is unsecured and there is no risk of default, the Council will not charge MRP because the principal sum of such a loan will have no consequences for the Council's revenue expenditure and it would be over-prudent to provide for the loan. However the Council will access these on a case by case basis.

Capital Investment with a Defined Life

- To apply Option 3 to projects as a 4% reducing balance amount would under-recover the expenditure over its useful life. The basis for projects over £250,000 (i.e. equal instatement or annuity basis) to be determined as part of each projects financing considerations. Projects under £250,000 will be grouped and a weighted average life across an equal instalment basis will be used.

Other elements of remaining debt

- That, in accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's continues to use the CFR method for calculating the Minimum Revenue Provision for supported capital expenditure.

5.7 The Council currently has no unsupported debt.

5.8 The MRP included in the revenue estimates is as follows:

MRP estimates	**2017/18 Approved £'000**	**2017/18 Revised £'000**	**2018/19 Budget £'000**	**2019/20 Budget £'000**	**2020/21 Budget £'000**
MRP	766	766	1,158	1,399	1,666

5.9 Members' attention is drawn to the fact that notwithstanding the MRP policy loan repayments continue to be made when they fall due.

[1] The Council may make loans to other parties to fund their capital expenditure. Government guidance is that MRP should be charged on the outstanding amount of any loan, based on amortising the loan principal over the estimated life of the assets in relation to which the other parties' expenditure is incurred. This is because lending to other parties has the same impact on the underlying need for an authority to borrow as expenditure on acquiring property.