

REPORT TO: FINANCE COMMITTEE - 12 JANUARY 2004

REPORT ON: THE PRUDENTIAL CODE

REPORT BY: DEPUTE CHIEF EXECUTIVE (FINANCE)

REPORT NO: 53-2004

1 PURPOSE OF REPORT

- 1.1 To provide elected members with background information on the legislation and implementation of the prudential code and in particular how the code will impact on Dundee City Council.

2 RECOMMENDATIONS

- 2.1 The Policy and Resources Committee is requested to:

- 1 instruct the Depute Chief Executive (Finance) and Director of Economic Development in consultation with other Chief Officers to come forward with a Corporate Asset Management Strategy.
- 2 instruct the Depute Chief Executive (Finance) to develop an Option Appraisal process for capital expenditure projects.
- 3 approve the Prudential Indicators for the financial year 2004/05 which are detailed in Appendix 1 to this report.
- 4 instruct the Depute Chief Executive (Finance), in medium to long term, to move towards implementing the definition of capital expenditure as contained in the Code of Practice on Local Authority Accounting, by liaising with Chief Officers to review future Capital Plans.

3 FINANCIAL IMPLICATIONS

None.

4 LOCAL AGENDA 21 IMPLICATIONS

None.

5 EQUAL OPPORTUNITIES IMPLICATIONS

None.

6 BACKGROUND

6.1 Legislation

The Prudential Code has been developed as a professional code of practice to support local authorities in taking decisions on capital investment. Local authorities will be required by Regulation, from 1 April 2004, to comply with the Prudential Code under Part 7 of the Local Government in Scotland Act 2003.

6.2 **Scope**

The Prudential Code applies to all local authorities, including Police, Fire and other authorities, as defined in Part 7 of the 2003 Act. The Code applies both to General Fund Departments, such as Education and Social Work etc and to the Housing Revenue Account.

6.3 **Objectives**

The objective of the Prudential code is to provide a framework which will ensure:-

- 1 that Local Authority capital expenditure programmes are affordable.
- 2 that Local Authority external borrowing and other long term liabilities are within prudent and sustainable levels.
- 3 that Local Authority Treasury Management decisions are taken in accordance with professional good practice.

The code also requires that in making decisions in relation to these objectives, Local Authorities are accountable by providing a clear and transparent framework.

6.4 **Requirements**

The Prudential Code requires that the framework established by each local authority to support its decision-making on capital expenditure and levels of external debt, is consistent with:

- asset management planning
- option appraisals

The Prudential Code further requires that each authority prepares a set of indicators that demonstrate that expenditure plans are affordable and prudent.

7 **ASSET MANAGEMENT PLANNING**

7.1 The Prudential Code requires Dundee City Council to introduce "Asset Management Planning". The objective of asset management planning is to ensure that the Council's assets are managed efficiently and effectively and that account is taken of their utilisation and ongoing cost implications. This should allow limited resources to be directed towards defined priorities.

7.2 Essential in an Asset Management Plan are the following:

- Description of assets together with information on condition and performance.
- Financial forecast of costs in the short, medium and long terms.
- Links between the asset and service and corporate plans.
- Information to identify decline in service potential.
- Improvement programmes and plans.

7.3 The Asset Management Plan should be approved by the Council and it should be the subject of regular review.

7.4 The Council's Education Department has already prepared an asset management plan for its schools. The School Estate Management Plan has been developed following a direction from the Scottish Executive to all local authorities and was approved at the Education Committee on 15 December 2003 (Report No 810-2003).

8 **OPTION APPRAISALS**

- 8.1 The Prudential Code will also require Dundee City Council to introduce a system of option appraisal for all capital expenditure proposals.
- 8.2 An "Option Appraisal" report will be required for each item of capital expenditure to be entered into the Council's capital plan. This report would "state the case" for individual projects and would be likely to include details of the following:
- Explanation of the need for the project.
 - How the project links into corporate and service plans and objectives.
 - Identification of the different options for achieving the aims of the project.
 - Assessment of the implications of not undertaking the project.
 - Impact of the project on service users.
 - Resourcing implications, both financial and human
 - Overall net benefits of the project
- 8.3 It is envisaged that each Option Appraisal will take the form of a committee report. However, in the case of projects with a total capital value of under £1m, then a less detailed option appraisal would be required.

9 PRUDENTIAL INDICATORS

- 9.1 The Prudential Code requires the Depute Chief Executive (Finance) to prepare a set of indicators which demonstrate that the Council's Capital Plan is affordable, prudent and sustainable. These indicators will be required for the Capital Plan 2003-2007 and subsequent plans. The indicators will be measured and reviewed annually, as a minimum.
- 9.2 The Prudential indicators required fall into two categories:
- Capital Expenditure Indicators
 - Treasury Management Indicators

The actual indicators which have been set for the Capital Plan 2003-2007 are set out in Appendix 1 to this report. The reasons behind the use of these indicators are set out below.

9.3 **Capital Expenditure Indicators**

9.3.1 **Level of Capital Expenditure to be met from Borrowing**

This indicator measures affordability and provides the most basic control on the Council's planned capital expenditure.

9.3.2 **Ratio of Financing Costs to Net Revenue Stream**

This is another measure of affordability. The measure of financing costs used will include both current commitments and future commitments based on the capital plan and shows the percentage of revenue expenditure directed towards the financing costs of capital expenditure.

9.3.3 **Estimate of Incremental Impact of Capital Investment Decisions on Council Tax and Rents**

This is a key measure of affordability. It shows the actual impact of capital investment decisions on the Council Tax and Housing Rents. This indicator takes into consideration the effects of self financing capital projects and the effects of government support. It also reflects the revenue impact of capital schemes other than financing costs, so facilitating the consideration of revenue intensive vis-a-vis capital intensive options.

9.4 **Treasury Management Indicators**

9.4.1 **Adoption of CIPFA Code of Practice for Treasury Management**

This is the main means of ensuring good professional practice. This has been adopted by the Council since 11 March 2002 when it was approved by the Finance Committee and the Council will continue to comply with the requirements of this Code.

9.4.2 Upper Limit for Borrowing that is at Variable Rate

This is an indicator of prudence. It has been set at the same level as in the Council's Treasury Management Strategy. Variable rate may be regarded as slightly more risky than fixed as the rates are liable to change and therefore not certain into the future. The Council would therefore wish to limit its exposure to this whilst recognising there are also potential benefits if rates are anticipated to move down.

9.4.3 Upper Limit for Borrowing that is at Fixed Rate

This is an indicator of prudence. It has been set to allow all the Council's borrowing to be at fixed rate if required. This ensures that all future liabilities are certain. However, there is a potential to lose if interest rates fall and the Council is unable to take immediate advantage.

9.4.4 Limit for Fixed Rate Borrowing Maturing in Each Period

This is another indicator of prudence. It is prudent for the Council to manage its Loan repayment profile to ensure that an undue amount of repayments do not fall due at the same time as this may lead to difficulty in re-financing. The limits have been set in light of the current maturity profile and with a view to being appropriate over the very long term.

9.4.5 Upper Limit for Sums invested for Longer than 364 days

Again this is a measure of prudence. However, Dundee City Council's policy is that sums would not be lent for as long as this.

9.4.6 Authorised Limit for External Debt and Other Long Term Liabilities

This is an indicator of affordability. The authorised limit is a worst case scenario and has been set with sufficient headroom over the operational boundary detailed in 9.4.7. This allows for highly unusual and exceptional cash movements and it is considered very unlikely that these limits would be approached.

9.4.7 Operational Boundary for External Debt and Other Long Term Liabilities

This is another indicator of affordability. It is similar to 9.4.6 in that it considers levels of external borrowing. However, this is based on a prudent and most likely case rather than worst case estimates. This is a key management monitoring tool. It would be possible that this limit could be breached for short periods of time on occasions during the year, due to the vagaries of the Council's cash flow position. However, more regular or sustained breaches would signal a need for investigation and action.

9.4.8 Estimates of Capital Finance Requirement

Again this is a measure of affordability. This represents the Council's underlying need to borrow for a capital purpose. To ensure that external debts are kept at prudent and sustainable levels, a key indicator is that net external borrowing should not exceed the estimated capital financing requirement in the medium term. The indicators in Appendix 1 clearly show that the operational boundary for external debt is estimated to be below the capital financing requirement throughout the period.

10 **DEFINITION OF CAPITAL EXPENDITURE**

10.1 The Prudential Code is very clear in the definitions which should be used for all purposes relating to the code. Definitions should be consistent with the CIPFA.LASAAC Code of Practice on Local Authority Accounting (the SORP). The SORP definition describes capital expenditure as,

- the acquisition, creation or enhancement of a fixed asset.
- substantially lengthening an asset's life.
- substantially increasing an asset's open market value.
- substantially increasing the extent to which an asset can be used.

Under this definition, improvement works and structural repairs can be capitalised but expenditure to ensure that the fixed asset maintains its previously assessed standard of performance should be treated as revenue expenditure.

10.2 In the medium to long term the Council's Capital Plans will be consistent with the definition of capital expenditure. The Depute Chief Executive (Finance) will make all Chief Officers aware of the change in definition, and then initiate a review of Department's capital expenditure programmes.

11 **BACKGROUND PAPERS**

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above Report.

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29 DECEMBER 2003

CAPITAL PLAN 2003-2007

1 Prudential Indicators - Capital Expenditure

1.1 Level of Capital Expenditure to be met from Borrowing

	2002/03 Actual £'000	2003/04 Estimate £'000	2004/05 Estimate £'000	2005/06 Estimate £'000	2006/07 Estimate £'000
Non-HRA	9,184	10,294	18,477	18,062	16,100
HRA	5,660	8,645	11,346	11,436	8,436

1.2 Ratio Financing Costs to Net Revenue Stream

	2002/03 Actual %	2003/04 Estimate %	2004/05 Estimate %	2005/06 Estimate %	2006/07 Estimate %
Non-HRA	7.5	7.8	7.4	7.5	7.8
HRA	29.2	29.6	30.5	31.8	33.8

1.3 Estimate Incremental Impact of Capital Investment Decisions on Council Tax/Rents

For Band D Council Tax

2004/05	2005/06	2006/07
nil	nil	nil

Average Weekly Housing Rents

2004/05	2005/06	2006/07
nil	nil	nil

2 Prudential Indicators - Treasury Management

2.1 Adoption of CIPFA Code of Practice for Treasury Management

2.2 Upper Limit for borrowing that is at variable rates less investments that are variable rate investments

%

2004/05 2005/06 2006/07

2.3 Upper Limit for borrowing that is at fixed rates less investments that are fixed rate investments

%

2004/05 2005/06 2006/07

2.4 Limit for 2004/05 for amount of projected borrowing that is fixed rate maturing in each period as percentage of total projected borrowing that is fixed at the start of the period

	Lower %	Upper %
Where the periods are:-		
Under 12 months	0	10
12months & within 24 months	0	15
24 months & within 5 years	0	25
5 years & within 10 years	0	25
10 years +	50	95

2.5 Upper limit for sums invested for periods longer than 364 days N/A

2.6 Authorised Limit for external debt with limit for borrowing and other long term liabilities separately identified

	Borrowing £000	Other £000	Total £000
2004/05	315,000	5,000	320,000
2005/06	335,000	5,000	340,000
2006/07	352,000	5,000	357,000

2.7 Operational Boundary for external debt with limit for borrowing and other long term liabilities separately identified

	Borrowing £000	Other £000	Total £000
2004/05	290,000	1,000	291,000
2005/06	310,000	1,000	311,000
2006/07	327,000	1,000	328,000

2.8 Estimates of Capital Financing Requirement

	non HRA £000	HRA £000	Total £000
2004/05	190,000	125,000	315,000
2005/06	200,000	132,000	332,000
2006/07	207,000	137,000	344,000

