Item No: 7.3	Classification: Open	Date: 20 July 2005	Meeting Name: Council assembly
Report title:		Prudential indicators on capital finance and treasury management 2004/05 outturn	
Wards or Groups affected:		All	
From:		Finance director	

RECOMMENDATIONS

1. Council assembly is are asked to note the 2004/05 outturn report on prudential indicators for capital finance and treasury management.

BACKGROUND

3. The council assembly agreed on 18 February 2004 a series of prudential indicators under a financial regime brought about by the Local Government Act 2003. Prior to that, capital finance and treasury management were regulated by the Local Government and Housing Act 1989.

4. The indicators support decisions on capital investment, borrowings and cash management and may only be determined or varied by council assembly. It is, however, the responsibility of the director of finance to carry out all strategic managerial and day to day operations associated with the indicators.

5. This report provides the authority's indicators for capital finance and treasury in 2004/05.

PRUDENTIAL INDICATORS SUMMARY

6. A detailed update on each prudential indicator and the treasury position for 2004/05 is set out in Appendix A. The key points are drawn out below.

7. Cash balances have grown following an expansion in right to buy council house sale and other cash receipts ahead of spending. The interest earned on cash has helped lower financing cost ratios.

8. Cash balances averaged £289 million over the course of 2004/05, against a closing balance of £211 million at end of the previous year. The debt outstanding to finance past capital expenditure has come down to £648.9 million as at the end of March 2005, a reduction of £3.2 million since the start of the financial year. No new borrowing was carried out in 2004/05 and the debt outstanding was well within borrowing limits.

9. The 2004/05 capital expenditure was £132 million and met fully from locally generated resources and Government supported borrowing approvals, without recourse to unsupported borrowing.

COMMENTS OF THE BOROUGH SOLICITOR

10. Regulations made under the Local Government Act 2003 require local authorities to have regard to the prudential code for capital finance, published by the Chartered Institute of Public Finance and Accountancy, when determining or changing prudential indicators.

11. Council is responsible for determining or changing the indicators. No changes are being proposed in this report.

BACKGROUND DOCUMENTS

Background Papers	**Held at**	**Contact**
Prudential Code for Capital Finance in Local Authorities	Financial Management Services	Dennis Callaghan, Chief Accountant (020 7525 4375)

Lead Officer	**Duncan Whitfield** Finance Director	
Report Author	**Duncan Whitfield**, Finance Director	
Version	Final	
Version Date	6/07/05	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Borough Solicitor & Secretary	Yes	Yes
Executive Member	Yes	No
Final Report Sent to Constitutional Support Services		8/07/05

APPENDIX A

PRUDENTIAL INDICATORS & TREASURY POSITION 2004/05

1. Prudential indicators help identify the affordability and prudence of capital investment on local taxation and rents, and set limits on borrowing and cash management activities. The position of the indicators taken from the 2004/05 accounts is set out below.

A: PRUDENTIAL INDICATORS FOR AFFORDABILITY.

INDICATOR ONE: RATIO OF FINANCING COSTS TO NET REVENUE STREAM

2. The financing cost ratio represents the share of debt financing costs and interest income as a % of the net revenue stream. The table below sets out the position for 2003/04 and 2004/05.

2. The 2004/05 actual reflects improvements in interest from growth in cash balances after expansion in right to buy sales and other receipts ahead of spending. This interest benefit will fall away over time as spending picks up.

FINANCING RATIO	2003/04 Actual	2004/05 Previous Estimate	**2004/05 Actual**
HRA	39.7%	34.0%	**32.7%**
GF	0.8%	0.2%	**-0.6 %**

INDICATOR TWO: ESTIMATES OF THE INCREMENTAL IMPACT OF CAPITAL INVESTMENT ON THE COUNCIL TAX AND HOUSING RENTS

3. When the council assembly drew up the 2004/05 prudential indicators, locally funded general fund unsupported capital borrowing of £7 million was assumed. None of this was not in fact needed as all expenditure was met from capital receipts, grants or Governments supported capital borrowing approvals.

B: PRUDENTIAL INDICATORS FOR PRUDENCE

INDICATOR THREE: CAPITAL EXPENDITURE

5. The actual capital expenditure for 2004/05 was £132 million, higher than previous estimate, reflecting spend pick-up towards the end of the year. The entire spend was however met from resources set aside for that purpose.

CAPITAL SPEND £m	2003/04 Actual	2004/05 Previous Estimate	**2004/05 Actual**
HRA	69	67	**82**
GF	44	55	**50**
Total	113	122	**132**

INDICATOR FOUR: CAPITAL FINANCING REQUIREMENT.

6. The capital financing requirement (CFR) reflects the borrowing outstanding to support past and current capital expenditure. The overall capital financing position at 31 March 2005 was £647 million, a reduction of £9 million over the

course of 2004/05, reflecting application of capital resources set aside for this purpose.

CFR £m	31/3/04 Actual	31/3/05 Previous Estimate	**31/3/05 Actual**
HRA	551	562	**562**
GF	87	93	**85**
Total	638	655	**647**

INDICATOR FIVE: AUTHORISED AND OPERATIONAL LIMITS ON DEBT

7. There are two limits on debt and long term liabilities; the authorised limit and the operational limit. The authorised limit is the higher of the two limits and accommodates unexpected borrowing that may be taken for very short periods. The operational limit accommodates existing debts and any temporary debt that may be taken for debt restructuring. The limits agreed by council assembly are set out in the table below.

LIMITS £m	2004/05 Authorised	2004/05 Operational	**2004/05 Max Actual**
Debt	750	717	**649**
Long term liabilities	15	14	**0**
Total	765	731	**649**

8. Actual debt was well below the authorised and operational limits throughout 2004/05. Debt opened 2004/05 at £652.1 million, virtually all from the Government's lending arm the public works loans board. Following a £3.2m repayment on 1 April 2004, it fell to £648.9 million, where it remained until the end of the year. The repayment was out of capital receipts and revenue provision set aside for that purpose.

9. Out of the £135 million 2004/05 capital spend, £18 million was met from Government supported capital borrowing approvals. However, no new borrowing was actually taken in 2004/05. Instead internal cash was used to settle expenditure, pending refinance with debt in the future.

C: PRUDENTIAL INDICATORS FOR TREASURY MANAGEMENT

INDICATOR SIX: ADOPTION OF THE CIPFA TREASURY MANAGEMENT CODE OF PRACTICE.

10. This indicator concerns the adoption of the code of practice for treasury management in the public sector issued by CIPFA, setting out a model for best practice. The council assembly adopted the code and its update back in 2002.

INDICATOR SEVEN: INTEREST RATE EXPOSURES – FIXED

INDICATOR EIGHT: INTEREST RATE EXPOSURES - VARIABLE

11. The 2004/05 limits on the percentage of net debt (net of investments) that may be at fixed rate or variable rates agreed by council assembly are set out below.

LIMITS ON INTEREST RATE EXPOSURE	2004/05 Limit Agreed	**2004/05 Maximum Actual**
Upper limit on net fixed rate debt	100%	**100%**
Upper limit on net variable rate debt	30%	**0%**

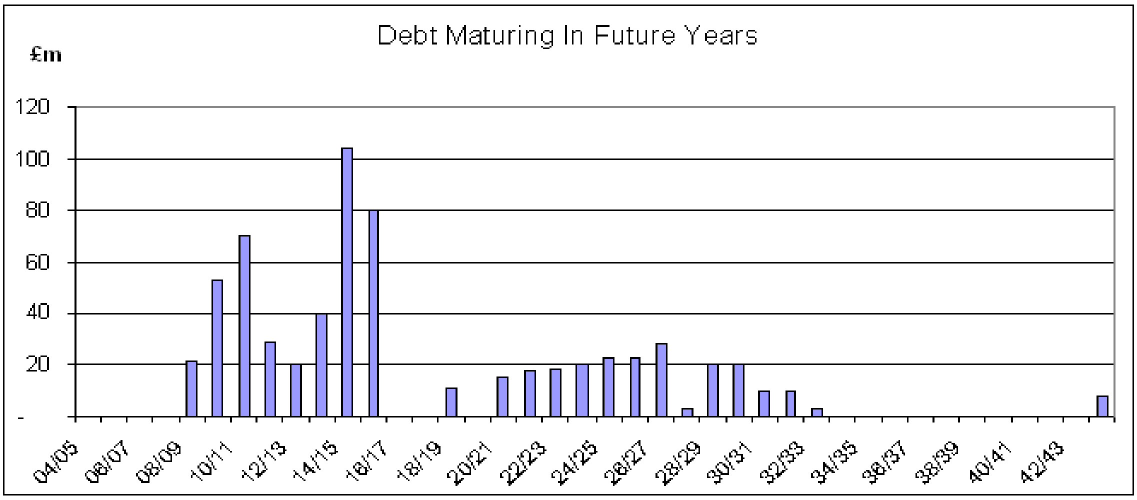
12. The council was within these limits. All the debt was at fixed rates. No new debts were taken on nor was any debt restructuring carried out. All investments in 2004/05 were at fixed rates for periods under one year.

INDICATOR NINE: MATURITIES

13. The 2004/05 indicators agreed by council assembly on debt that may mature in any one period is set out below.

MATURITY LIMITS	Under 1 year	12 months and under 2 years	2 years and under 5 years	5 years and under 10 years	10 years or above
Upper Limit	25%	25%	60%	80%	80%
Lower limit	0%	0%	0%	0%	0%
Actual 2004/05	**0%**	**0%**	**3%**	**33%**	**64%**

14. The council was within these maturity limits, reflecting the fixed rate long maturity nature of its debts; refer maturity profile below. No refinancing activity was carried out in 2004/05 to affect this basic structure. However developments in funding conditions may well make it attractive to alter the profile in the future.



15. The overall average rate of interest on debt is 9.1%, high relative to current base rates of 4.75%. The average reflects the period in the1980's when high capital investment and debt taken to support it coincided with high inflation and high interest rates. As well as being higher than base rates, the council's average rate of interest on debt is also high relative to many neighbouring authorities. However, the council is largely insulated for these high costs though support arrangements, which reimburse interest pound for pound on

housing debt (approximately 87% of all debt) and partially reimburse the remainder thorough formula grant.

INDICATOR TEN: TOTAL PRINCIPAL SUMS INVESTED FOR PERIODS LONGER THAN 364 DAYS.

16. The 2004/05 upper limit on exposure to 1 year agreed by council assembly is set out in the table below. The council was within these limits in 2004/05.

UPPER LIMITS ON INVESTMENTS BEYOND 1 YEAR IN 2004/05	1 year or more & under 5 years	Over 5 and under 10 years
Upper limit	£30 m	£10 m
Actual 2004/05	**£1 m**	**£0 m**

17. Cash is managed by an inhouse operation and an external firm, Invesco Asset Management Ltd, part of the large global UK quoted investment group AMVESCAP Plc. Invesco are used to gain exposure to longer term investments. Almost all investments were held in deposits of under 1 year, enabling benefits from the rising interest rate environment that prevailed in 2004/05 to be secured. At 31 Mar 2005 £273 million was held in house and £24 million was managed by Invesco, across counterparties set out below. The overall investment return in 2004/05 was 4.7%, with both Invesco and inhouse producing similar returns.

DEPOSITS AT 31 March 2005 Counterparty	**Country ***	**Inhouse £m**	**Invesco £m**
Abbey National Plc	UK	13.0	4.8
Australia New Zealand Banking Corp	Australia	15.0	
Barclays Bank	UK	20.0	5.0
Banco Bilbao Vizcaya Argentaria	Spain	10.0	
Bank of Ireland	Ireland		
Bank of Montreal	Canada	10.9	
Bank of Nova Scotia	Canada	20.0	
JP Morgan Chase	US	0.0	
Deutsche Bank	Germany	15.0	
HBOS - Halifax Bank of Scotland	UK	20.0	1.4
Landesbank Baden Wurttemberg	Germany	10.0	
Lloyds Bank	UK	20.0	5.0
National Australia Bank	Australia	15.0	2.7
Nationwide Building Society	UK	15.0	2.4
RBOS – Royal Bank of Scotland NatWest	UK	23.7	3.1
Rabobank	Netherlands	20.0	
Societe Generale	France	20.0	
Svenska Handelsbanken	Sweden	15.0	
UBS – Union Bank of Switzerland	Switzerland	5.0	
Unicredito Italiano	Italy	5.0	
Total £m		**272.6**	**24.4**

(*)All deposits with UK Branches