

Item No: 7.2	Classification: Open	Date: 28 June 2006	Meeting Name: Council Assembly
Report title:		Prudential Indicators For Capital Finance & Treasury Management 2005/06 Outturn	
Wards or Groups affected:		All	
From:		Finance Director	

RECOMMENDATION

1. That the Council Assembly note this 2005/06 outturn report on prudential indicators for capital finance and treasury management.

BACKGROUND INFORMATION

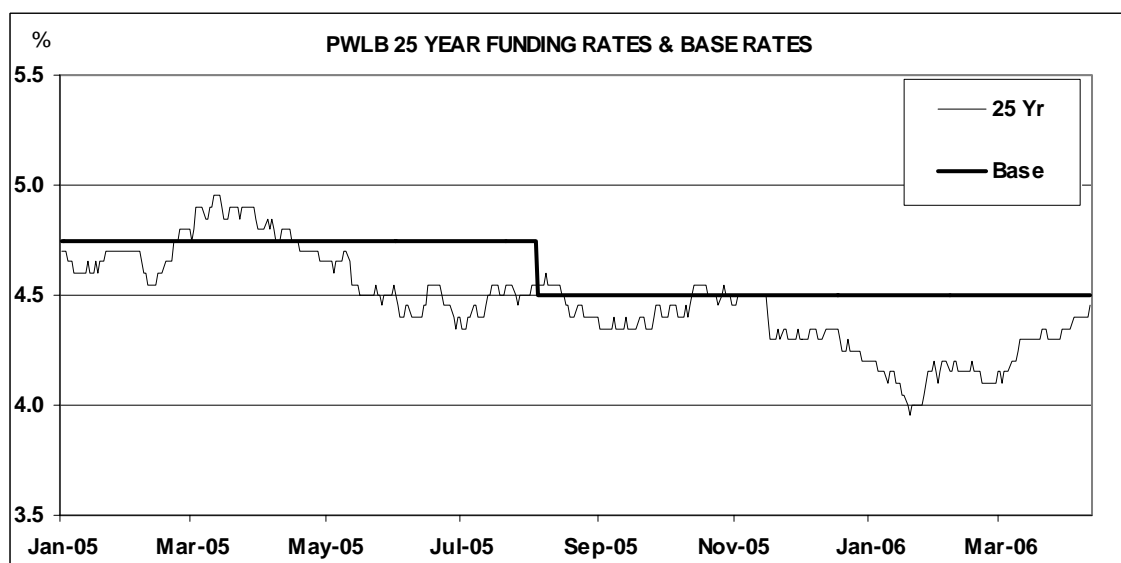
2. Prudential indicators combine arrangements over capital finance, borrowing and investment in a series of estimates and limits. The regime for the indicators was brought in by the Local Government Act 2003, supporting regulations and the Prudential Code for Capital Finance in Local Authorities, published by the Chartered Institute of Public Finance and Accountancy (CIPFA).
3. The indicators for 2005/06 were agreed by Council Assembly on 23 February 2005, and updated on 22 Feb 2006. Responsibility for carrying out the capital finance, borrowing and investment activities underlying the indicators rests with the Finance Director and this report sets out the outturn position on those activities for 2005/06.

ISSUES FOR CONSIDERATION

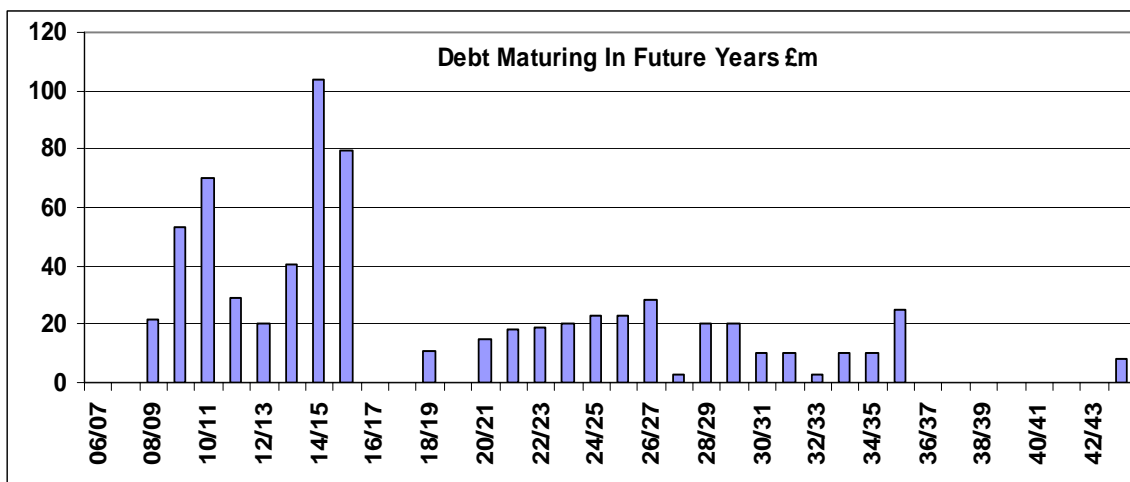
CAPITAL FINANCE, BORROWING AND INVESTMENTS

4. Key capital finance, borrowing and investment activities for 2005/06 are set out below. A detailed outturn position on each prudential indicator for 2005/06 is set out in Appendix A.
5. Capital spending in 2005/06 totalled £152 million (£134 million 2004/05). Of this, £32 million was met from Government supported borrowing approvals - the rest from capital receipts, revenue contribution and grants.
6. The provision to fund up to £7 million General Fund capital expenditure in 2005/06 out of locally funded prudential borrowing was not used in the year. The funding - which is was originally for "invest to save" initiatives, but was subsequently earmarked for the acquisition of the Old Kent Road Gasworks site for the Waste PFI project (to protect the Council investment in view of the London Mayor's proposal for a Single Waste Authority) - is now expected to be used in 2006/07. An assessment of what additional capacity there remains for further "invest to save" initiatives will now be considered as part of the review of the Council's Medium Term Financial Strategy, which is currently under way.
7. £45 million in new loans were taken on to meet 2005/06 and future supported borrowing approvals. The loans were at fixed rates of interest from the Public Works loans Board (PWLB, a division of the HM Treasury) and mature between 2033 and 2035. The average rate of interest on the loans was 4.4%, which is close to the average rate for this kind of

funding in 2005/06, refer chart below, and less than half the average rate payable on existing loans.



- The new loans raised debts outstanding to £694 million at the close of 2005/06 (£649 million 31 March 2005), which is within the operational limit of £750 million for the year. No loans fell for repayment in 2005/06, nor were any paid off early due to the penalties (the premiums) payable under current re-financing conditions. All the debt is at fixed rate and virtually all from the PWLB. The sum maturing each year is shown in the chart below.



- The average rate of interest payable on all these loans is 8.96%, high relative to current rates and a reflection of the high rate and high inflation period of the 1980's and early 1990's, unlike conditions prevailing currently, when most of the loans were taken on. However, as most of the interest payable on the debt is reimbursed in support by the Government, the impact on Council finances from the high rate is minimal. Housing Revenue Account Subsidy is currently payable on 85% of the debt at the Council average rate and an allowance is included in Formulae Grant for the General Fund element.
- Cash balances closed 2005/06 at £273 million, having opened the year at £295 million. Over the course of the year, balances averaged £302 million (£287 million 2004/05). The movement in balances reflects day to day revenue activities as well as the flow of capital receipts, payments and financing. The cash is invested according to an investment strategy, drawn up using Government guidelines and approved by Council Assembly. The

investments themselves are diversified across a number of counterparties which can include the Government, local authorities, and large high rated banks and building societies. Investment risk is further contained by placing limits on maturities that exceed one year. Day to day investment management is carried out by an inhouse operation and Invesco Asset Management Ltd, part of the large UK investment group AMVESCAP. Currently the bulk of the cash is managed inhouse, in deposits of up to 1 year, and £26 million is held by Invesco, in deposits and Government Gilts of up to 2 years. Investment returns reflect short term money market rates, which in turn follow base rates. In 2005/06 the overall annual return was 4.74%, against average base rates of 4.58%. The counterparty exposure as at 31 March 2006 is set out in the table below – the deposits have a maturity of up to one year and UK Government Gilts up to 2 years.

CASH INVESTMENTS as at 31 March 2006	
Counterparty	£m
Allied Irish Bank	25
Australia & NZ Banking Corp	25
Bank of Montreal	16
Barclays Bank	15
Deutsche Bank	25
HBOS	9
HSBC	3
LloydsTSB	30
Nationwide Building Society	19
Rabobank	25
RBOS	22
Societe Generale	26
Svenska Handelsbanken	5
UBS	25
UK Gilts	5
Total £m (*)	275

(*) Represents £273m Council Cash & £2m Trust Fund cash.

11. Earlier this year a tendering exercise was initiated to increase funds managed externally and widen the range of prudent investment options available to the Council. This exercise is expected to be completed later this year and it is envisaged that the new arrangements will be in place in 2007.

COMMENTS OF THE BOROUGH SOLICITOR

12. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Code of Practice on Treasury Management, both published by the Chartered Institute of Public Finance and Accountancy, when determining or changing borrowing limits or prudential indicators. Reference should also be made to the ODPM Guidance on Local Authority Investments.
13. The Council Assembly is responsible for determining or changing the indicators. No changes are being proposed in this report.

REASON FOR LATENESS

14. This report could not be finalised until the 2005/06 Annual Accounts which are elsewhere on the agenda were completed.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
Prudential Code for Capital Finance in Local Authorities. Code of Practice on Treasury Management. ODPM Investment Guidelines.	Financial Management Services, Strategic Services Department	Dennis Callaghan, Chief Accountant (020 7525 4375)

Lead Officer	Duncan Whitfield , Finance Director	
Report Author	Simon Hughes , Assistant Finance Director	
Version	FINAL	
Version Date	17/06/06	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments Included
Borough Solicitor & Secretary	Yes	Yes
Final Report Sent to Constitutional Support Services		17/06/06

Appendix A Prudential Indicators Details Analysis 2005/06 Outturn

PRUDENTIAL INDICATORS 2005/06 OUTTURN

1. Prudential Indicators bring together arrangements over capital finance, borrowing and investment in a series of estimates and limits to give a general picture of the affordability and prudence of financing activities. The indicators are defined in the Prudential Code for Capital Finance, published by the Chartered Institute of Public Finance and Accountancy (CIPFA), and backed by the Local Government Act 2003.
2. On 23 February 2005, the Council Assembly approved the indicators for 2005/06 to 2007/08 and on 22 February 2006, the Council Assembly received a report about the 2006/07 to 2008/09 indicators, which included updated projections for 2005/06. This Appendix now sets out the 2005/06 outturn position on the indicators, which are grouped into three broad areas: affordability, prudence and treasury management.

CRITERIA ONE: INDICATORS ON AFFORDABILITY

INDICATOR ONE: RATIO OF FINANCING COSTS TO NET REVENUE STREAM

3. Financing costs represent the annual cost of financing past and current capital expenditure after taking account of income from working balances. The actual 2005/06 financing ratio for the Housing Revenue Account (HRA) and the General Fund (GF) are set out in the table below. Changes in the ratios over the previous year reflect changes in both financing costs and net revenue streams. The different pattern of the HRA and GF ratios reflects the different financing arrangements that apply to the two services. The ratios do not, in themselves, show the net of subsidy debt servicing costs falling on budgets, which, as set out in the body of the report, is minimal after taking account of Government support arrangements.

FINANCING RATIO	2004/05 Actual	2005/06 Previous Projection	2005/06 Actual
HRA	32.7%	35.4%	34.2%
GF	-0.5%	-0.7%	-0.7%

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

4. When the Council Assembly drew up the 2005/06 indicators on 23 February 2005, a provision to fund up to £7 million General Fund capital expenditure out of locally funded prudential borrowing was made. Since then the Executive and Council Assembly determined that this funding was to be used to acquire the Old Kent Road Gasworks site for the Waste PFI project in order to protect the Council investment in view of the London Mayor's proposal for a Single Waste Authority. As negotiations over the purchase of the site have yet to be completed, the £7 million prudential funding will now fall into 2006/07 spending, rather than 2005/06.

**Appendix A
Prudential Indicators Details Analysis 2005/06 Outturn**

CRITERIA TWO: INDICATORS FOR PRUDENCE

INDICATOR THREE: CAPITAL EXPENDITURE

5. The outturn capital expenditure for 2005/06 was £152 million, short of a previous projection £182 million. The balance will now be re-programmed into 2006/07.
6. £32 million of the actual 2005/06 spend was met from Government supported borrowing approvals, the rest came from capital receipts, revenue contribution and grants.

CAPITAL SPEND £m	2004/05 Actual	2005/06 Previous Projection	2005/06 Actual
HRA	83	100	88
GF	51	82	64
Total	134	182	152

INDICATOR FOUR: CAPITAL FINANCING REQUIREMENT

7. The capital financing requirement (CFR) shows the use of borrowing to finance past and current capital expenditure, net of repayments. The increase in the CFR since March 2005 reflects the actual 2005/06 capital spend financed through borrowing (£32 million) less the repayment obligations.

CFR £m	31/3/05 Actual	31/3/06 Previous Projection	31/3/06 Actual
HRA	562	586	586
GF	91	101	97
Total	653	687	683

INDICATOR FIVE: THE AUTHORISED AND OPERATIONAL LIMITS

8. These two limits represent the debt and long term liabilities outstanding on any one day. The lower limit is the operational boundary and takes account of ordinary activity. The authorised limit is the higher limit and accommodates unexpected borrowing that may be needed for very short periods. The total authorised limit is the limit councils have to determine under the Local Government Act 2003.
9. In 2005/06 £45 million in new loans were taken on to meet 2005/06 and future year capital borrowing approvals. This raised the cumulative historical debt outstanding to finance current and past Housing and General Fund capital expenditure to £694 million, which is within both the operational and authorised limits for 2005/06 (£750 million and £780 million respectively).

Appendix A
Prudential Indicators Details Analysis 2005/06 Outturn

LIMITS £m	2005/06 Authorised	2005/06 Operational	2005/06 Max Actual
Debt	780	750	694
Long term liabilities	15	14	0
Total	795	764	694

10. The Council has no long term liabilities at the moment. The limit accommodates liabilities that may be taken in place of borrowing to finance assets.

CRITERIA THREE: TREASURY MANAGEMENT INDICATORS

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

11. This indicator confirms that the Council has adopted the code of practice for Treasury Management in the Public Sector issued by CIPFA and updated in 2002. At Southwark, the original code was adopted when it was first produced in 1992 and the latest version was adopted by the Council in February 2003.

INDICATOR SEVEN: INTEREST RATE EXPOSURES – FIXED

INDICATOR EIGHT: INTEREST RATE EXPOSURES - VARIABLE

INDICATOR NINE: MATURITIES

12. The interest rate exposure gives an indication of the variability of financing costs to interest rate changes. The Council's exposure to interest rate changes is limited. The entire £694 million debt is at fixed rates, with no debts maturing over the next two years. The cash investments (£273 million at March 2006) are also at fixed rates, but here the maturities are shorter (averaging under 1 year) and so more sensitive to base rate changes.

LIMITS ON INTEREST RATE EXPOSURE	2005/06 Limit Agreed £m	2005/06 Maximum Actual £m
Upper limit on net fixed rate debt	795	694
Upper limit on net variable rate debt	200	0

13. The sums in debt falling for repayment in the future continue to reflect the basic fixed rate/fixed maturity nature of the debt. In 2005/06 £45 million in fixed rate loans were taken on at an average rate of 4.4% maturing between 2033 and 2035 and no debts were refinanced ahead of their normal maturity date, as refinancing conditions were not attractive. The debt percentage maturing in future years is set out below, which was within agreed limits.

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 2005/06	0%	0%	11%	38%	51%

Appendix A
Prudential Indicators Details Analysis 2005/06 Outturn

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

14. The Council's cash balances averaged £302 million over the course of 2005/06. During the year, the bulk of the balances were held in deposits of up to one year. In view of interest rate uncertainty, exposure beyond that was limited to the £11 million placed in 2 year Government Gilts. Further details about the investments are set out in the body of the report.

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	£50 m	£20 m
Actual Max in 2005/06	£11 m	£0 m