



Finance
and
Systems

Prudential Indicators Guide September 2023

The Prudential Code

- 2003 Local Government Act & 2003 Capital Finance Regulations - introduced the Prudential Code
 - Freeing LG from centrally imposed borrowing controls
 - Manage own affairs according to the sector's own professional standards.
- Local authorities determine their own programmes for capital investment in non-current assets that are central to the delivery of quality local public services.
- The Prudential Code has been developed by CIPFA as a professional code of practice to support them in taking these decisions.
- The Prudential Code, along with the Treasury Management Code form two parts of what is known as the Prudential Framework. In England, the other two parts are statutory guidance published by MHCLG - Guidance on Local Authority Investments and the Guidance on Minimum Revenue Provision (MRP).

What are Prudential Indicators?

- Local authorities are required by regulation to have regard to the Prudential Codes for Capital Finance and Treasury Management. These Prudential Codes require that all capital expenditure, investments and borrowing decisions are **prudent, affordable** and **sustainable**.
- In 2021 the Code was updated to report and monitor a suite of Prudential Indicators
 - on at least a quarterly basis during the financial year.
 - to support and record local decision making in manner that is publicly accountable.
 - demonstrate that the Authorities' capital expenditure, investments and borrowing activities are prudent affordable and sustainable.
- The prudential indicators cover the three areas
 - Capital Expenditure
 - Treasury Management Indicators
 - Affordability

The indicators are approved and set by the Council in February each year as part of the wider budget setting process. These indicators are then reviewed and restated during the year as part of the periodical budget monitoring.

The Required Prudential Indicators

Capital expenditure indicators:

- Estimates of capital expenditure;
- Estimates of Capital Financing Requirement;

Treasury Management Indicators

- Liability benchmark
- Upper and lower limits to the maturity structure of its borrowing
- Upper limits for long-term treasury management investment
- Authorised limit and Operational Boundary for external debt;
- Gross debt and the Capital Financing Requirement (CFR);

Affordability indicators

- Estimates of financing costs to net revenue stream;
- Estimates of net income from commercial and service investments to net revenue stream;

Limitations and Considerations

Limitations

- Lack of potential meaningful comparison or benchmarking with other councils
- What represents an area of risk eg Financing Cost to Net Revenue Stream , is 2%,5%, 10% an issue ?
- Some indicators are clear eg Gross Debt must not exceed CFR, others state agreed levels eg Capital Expenditure budget

Considerations and questions for Accounts and Audit Committee ?

- Pattern and trend ? – increasing/decreasing over time – is external debt increasing, is reliance on commercial investments increasing ?
- What is impact if commercial income drops ?
- Have agreed levels been breached/likely to be breached ?

Office for Local Government (OfLOG) launched recently

- Data Explorer to detect emerging risks of failure, judgement of failure that necessitates formal intervention. Set of nine initial indicators and will increase
- Meaningful comparisons with others – eg Total Debt as % of CSP, Debt Servicing as % of CSP

Gross Debt and the Capital Financing Requirement (CFR)

The Council needs to ensure that its gross debt does **not, except in the short term**, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is **not undertaken for revenue or speculative purposes**.

This indicator will be updated at year end 2023/24.

The latest available figures based on actuals at 31st March 2023, show

- CFR of £412.0m
- External Debt of £320.6m
- A head room of £91.4m meaning that internal borrowing has been used to this level to fund previous capital investment.

Focus - Affordability Indicators

The fundamental objective in the consideration of the affordability of the authority's capital plans, including its Asset investment Strategy, is to ensure that the level of investment remains within sustainable limits.

1) Estimates of Financing Costs to Net Revenue Stream (NRS)* - this indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the Council's NRS. This demonstrates the **affordability** and **proportionality** of that borrowing by comparing it to the Council's NRS as a whole.

2) Estimates of Net Income from Commercial and Service Investments to NRS - This indicator compares income, net of operational costs but not financing costs, from commercial investments to the Council's NRS. As above, this comparison allows for consideration for the Council's **reliance** on that income and its **proportionality**.

These sustainable limits are therefore an assessment of what proportion of the NRS is deemed acceptable to be at risk from financing and investment activity.

* **NRS** = Tax and Non-Specific Grant Income eg Council Tax, Rates, General Funding Grants eg NHB

Affordability - Financing Costs to NRS

Prudential Indicators – 2023 to 2026	2023/24	2024/25	2025/26
	%	%	%
Net Financing Costs to NRS - original approved in February 2023	3.4%	3.1%	3.3%
Net Financing Costs to NRS - New calculation method at P4	-0.7%	3.7%	4.4%

Net Financing Costs = Loan Principal (Minimum Revenue Provision), interest payments **Less** Gross Investment Income

Gross Investment Income = interest earned from Treasury investments plus interest income from capital loans (within the Asset Investment Programme).

The forecast for 2023/24 is negative due to the inflow of interest payments to the Council, i.e. investment income, being higher than the outflow of interest payments, i.e. cost of external borrowing.

See next slide.

Affordability - Financing Costs to NRS

Affordability - Financing Costs	2023/24	2024/25	2025/26
Net Revenue Stream (£k)	201,972	207,681	207,375
Net Financing Costs * (£k)	(1,383)	7,591	9,028
Net Financing Costs to NRS (correct Prudential Indicator)	(0.7)%	3.7%	4.4%
Gross Financing Costs (£k)	13,428	12,831	12,924
Gross Investment Interest Income (£k)	(14,811)	(5,240)*	(3,896)*
Net Financing Costs (£k)	(1,383)	7,591	9,028
Using Gross Financing Costs to NRS	6.65%	6.18%	6.23%

* This is assumed income on pipeline investments at P4. Needs to be adjusted to reflect assumed budget for 2024/25 and 2025/26. Will be updated a P6.

The prudential indicator requires a comparison between Net Financing Costs and the Net Revenue Budget, however this does not demonstrate fully the risk due to the high levels of investment income that the Council generates.

The **Gross** Investment Interest Income and **Gross** Financing Costs are more appropriate

- Risk of losing Gross Investment Income as this pays for borrowing costs
- Gross Financing Cost is the amount of exposure you need to pay

What is this telling us ?

Gross Financing Costs

Reliance and Proportionality ?

- Reliance is in the range of 6% (target) over the three years.
- Is a negative indicator an issue ?
- Need to include Gross in future indicators (local)

Gross Investment Income

- Higher than anticipated due to favourable return due to interest increases (reported P4)
- Need to review how we treat PI's for year 2 and 3 (keep to budget figures)
- We are not anticipating any budget increase in 2024/25 in investment returns (reliance on the investment programme is reducing)

Affordability – Net Income from Commercial and Service Investments (NICSI) to NRS

This indicator compares income from commercial investments to the Council’s NRS. This comparison allows for consideration for the Council **reliance** on that income and its **proportionality**.

Prudential Indicators – 2023 to 2026	2023/24	2024/25	2025/26
	%	%	%
NICSI to NRS - original approved in Feb 2023	8.5%	7.1%	6.8%
Forecast at Period 4	8.1%	6.5%	6.2%

The NICSI is inclusive of the income from the Asset Investment Strategy, and investment properties, such as high street shops. For the purpose of this indicator, financing costs are not included.

Proportionality

An objective of the Prudential Code is that the risks associated with service and commercial investments are "proportionate to their financial capacity – ie that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services".

The Prudential Code does not prescribe a defined proportion, and proportionality is expressed broadly in relation to an authority's financial capacity: the ability for any losses to be absorbed in existing budgets or useable revenue reserves

This is closely related to the authority's risk appetite, and the two can be considered together: how much downside risk from investments is the authority capable, and willing, of managing within its revenue budget.

What is this telling us ?

Net Income from Commercial and Service Investments to NRS

Reliance and Proportionality ?

- Reliance is in the range of 8.5% to 6.8% (target) over the three years
- Reliance is reducing from 8.5% to 6.8% (target)
- Forecast of actuals shows we are below target – impact in current year and changes to future assumptions

Questions and Challenge from Accounts and Audit Cttee

- Is our reliance high or low ? How do we compare ?
- Is the reduction/increase in reliance appropriate – thoughts and challenge ?
- Actuals are below target ? Investment income is below budget , what are implications ?

Affordability – Net Income from Commercial and Service Investments to NRS

- The Council relies on income from commercial and service investments to support the revenue budget. Should this income not be received or change by a small relative % (ie income drops 10%) then the revenue budget, and associated spend, may need to be reduced to meet the deficit.
- The level of income originally forecast to be received in 2023/24 is equivalent to 8.1% of the revenue budget, which at £17.34m would be a significant reduction in the Council's spending power. For comparison, below are some service areas funded from the revenue budget and their budget for 2023/24:

2023/24 Service Budgets	£m
Library Service	2.23
Human Resources	1.40
ICT	2.88
Highways Maintenance	2.21
Waste Collection	5.54
Children with Complex and Additional Needs	1.31
	15.57

Benchmarking – Prudential Indicators

2023/24 Prudential Indicator Forecast	Trafford	Warrington	Stockport	Salford	Oldham
Financing Costs to NRS	-0.7%	7.00%	9.60%	Not reported in Feb 2023	11.25%
Net Income for commercial and service investments to NRS	8.1%	Not reported in Feb 2023	Not reported in Feb 2023	Not reported in Feb 2023	Not reported in Feb 2023

Benchmarking – OFLOG

Total Debt as % of Core Spending Power

	2021-22 %	2020-21 %
Sample of Statistical Neighbours		
Trafford	207.90	253.40
Thurrock	1047.00	1074.60
Warrington	968.60	823.10
Reading	388.80	416.80
Stockport	317.00	330.70
Solihull	269.40	272.00
Cheshire West and Chester	144.80	147.20
Bournemouth, Christchurch and Poole	144.70	150.40
South Gloucestershire	127.40	129.80
Average Statistical Neighbours	306.1	309.15
Authorities in Financial Trouble (S114 Notice)		
Croydon	478.60	516.50
Reading	388.80	416.80
Hastings	537.10	575.40
Woking	14,643.60	7,860.60
Thurrock	1047.00	1074.60
Slough	737.10	643.90

Debt servicing as % of Core Spending Power

	2021-22 %	2020-21 %
Sample of Statistical Neighbours		
Trafford	10.90	11.60
Thurrock	0.00	28.20
Warrington	22.10	23.50
Reading	15.50	23.00
Stockport	11.90	12.10
Solihull	12.80	12.40
Cheshire West and Chester	15.30	7.90
Bournemouth, Christchurch and Poole	4.60	4.10
South Gloucestershire	3.60	3.80
Average Statistical Neighbours	11.15	11.85
Authorities in Financial Trouble (S114 Notice)		
Croydon	16.00	14.40
Reading	15.50	23.00
Hastings	27.70	26.90
Woking	0.00	321.90
Thurrock	0.00	28.20
Slough	9.90	9.10

Thurrock – Case study

- Between 2016 and 2022 Thurrock Council pursued a strategy of borrowing large amounts of money (and not just for capital purposes) and using this to undertake a range of investments for the purposes of securing a return. But the Council failed to understand and control the risks of this investment strategy. The ultimate failure of the strategy, and the scale of the financial loss that has resulted has undermined the financial viability of the authority and will require significant external support to be provided. The Council issued a Section 114 notice in December 2022
- An inspection report in May 2023 found serious weaknesses in internal control and internal governance, with a lack of transparency and complacency in regard to investment activity.
- [Thurrock Council Best Value Inspection Report \(publishing.service.gov.uk\)](#)
- [BBC iPlayer - Panorama - The Millionaire Who Cheated a Council](#)

Thurrock – Affordability Indicators

- Thurrock’s Affordability Indicators in February 2022 demonstrate a Council which is reliant on a large amount of investment income funded through high levels of borrowing:

Affordability Indicators Forecasts Thurrock Council February 2022	2021/22	2022/23	2023/24	2024/25
Financing Costs to NRS	-14.64%	-8.67%	-6.04%	-3.25%
Net Income from Commercial and Service Investments to NRS	23.29%	26.41%	27.81%	27.30%

- The indicator in the following year show the removal of that income and the impact of the residual borrowing costs which are now unaffordable:

Affordability Indicators Forecasts Thurrock Council February 2023	2021/22 (Actual)	2022/23	2023/24	2024/25
Financing Costs to NRS	76.00%	89.00%	128.00%	117.00%

Levelling Up and Regeneration Bill: capital risk metrics

- DLUHC has launched a consultation on the capital risk metrics it will be required to monitor for English local authorities when the Levelling up and Regeneration (LUR) Bill makes it through Parliament.
- Any authority breaching a given threshold for a capital risk metric will be investigated further and may receive a risk mitigation direction from DLUHC requiring it to take action such as selling property and using the proceeds to repay debt.
- The LUR Bill sets out four risk metrics, but the detailed methods of calculation are to be included in regulations. Draft metrics for Trafford will be reported as part of the suite of Prudential Indicators in future reporting

Levelling Up and Regeneration Bill: capital risk metrics

The LUR Bill sets out the below four risk metrics:

1. The total of a local authority's debt (including credit arrangements) as compared to the financial resources at the disposal of the authority.
2. The proportion of the total of a local authority's capital assets which is investments made, or held, wholly or mainly in order to generate financial return.
3. The proportion of the total of a local authority's debt (including credit arrangements) in relation to which the counterparty is not central government or a local authority.
4. The amount of minimum revenue provision charged by a local authority to a revenue account for a financial year.

Considerations for A&A Committee

Summary

- Prudential Indicators are complicated but important
- Lessons to learn - new and will continue to refine for year 2 and 3
- Limitations – comparison/ benchmarking
- OFLOG benchmark favourable when compared with others

- When considering affordability, risk is an important factor to be considered. Risk analysis and management strategies should be taken into account. What level of risk is appropriate for the Council and how should those risks be monitored and managed?

- The Council's Prudential Indicators for affordability are reflective of actual or planned investment activity. Does the governance structure, approval process and due diligence for those investments adequately reflect the risks involved?

Key Questions from A&A Cttee

- Does the CFR to Debt Ratio look reasonable ?
- Has external borrowing been undertaken purely to finance capital expenditure as agreed by the Council ?
- What is the trend in the Affordability Indicator (Financing Costs to Net Revenue Stream)
- Is the level of income from commercial investments proportionate to the Council's Budget ?
- How do we benchmark against other similar authorities ?