To: Council

On: 16 December 2021

Report by: Director of Finance & Resources

Heading: A Prudential Framework for Capital Finance – Progress Report

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1. **Summary**

1.1 The Local Government in Scotland Act 2003 and supporting regulations require local authorities to have regard to The Prudential Code for Capital Finance in Local Authorities ("the Prudential Code").

1.2 The Council set its prudential indicators for 2021/22 on 4th March 2021. The purpose of this report is to consider the indicators as they stand at 15th October 2021, approximately halfway through the financial year, and revise them as appropriate

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2. **Recommendations**

2.1 It is recommended that members consider this report and approve the changes to the prudential indicators as detailed in the report.

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3. **Background**

3.1 The key objectives of the Prudential Code are to ensure, within a clear framework, that:

- Capital investment plans are affordable, prudent and sustainable;
- Treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved;
- That these risks will be managed to an acceptable level to the organisation;

- Capital investment plans are being made in light of the overall organisational strategy and resources, ensuring that decisions are being made with sufficient regard to the long run financial implications and potential risks to the authority.

3.2 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used and the factors that must be taken into account. The Code does not include suggested indicative limits or ratios. These are for the Council to set itself.

3.3 The prudential indicators required by the Code are designed to support and record local decision making. The system is specifically designed to support such local decision making in a manner that is publicly accountable. They are not designed to be comparative performance indicators.

3.4 CIPFA has recently issued a secondary consultation on updates to the Prudential Code following an initial consultation in early 2021. The main focus of the consultation is to bring greater clarity over any commercial investments which may result in some changes or amendments to the Prudential Indicators. The revised version of the Prudential Code is not expected to be issued until Spring 2022 and would therefore potentially not be incorporated into the Council position until the Prudential Indicators for 2023/24 are considered.

4 CAPITAL EXPENDITURE INDICATORS

4.1 The Council has a duty to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure.

4.2 The Council is required to make estimates of the capital expenditure it plans to incur for the forthcoming financial year and at least the following two years. Separate estimates should be made for Housing and Non Housing services. The Capital Investment Programmes for Housing and Non Housing Capital Investment Programme were approved by Council on the 4th March 2021, the resulting indicators were updated to reflect the approved programme incorporating the decisions taken by the council at the budget meeting.

4.3 Council approved the following as an indicator for capital expenditure:-

CAPITAL EXPENDITURE

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Non Housing*	114,129	119,014	84,723
Housing	25,602	46,917	53,465
Total	**139,731**	**165,931**	**138,188**

*The 2021/22 Non Housing estimate excludes the estimated expenditure in relation to the Private Sector Housing Grant.

4.4 Total capital expenditure to 15th October 2021 is £31.009m, of which £22.179m relates to Non Housing and £8.921m relates to Housing.

4.5 A review of the updated capital spending plan for 2021/22 suggests that the indicators need to be revised as follows for the current year. Indicators for 2022/23 and 2023/24 will be reviewed in March 2022 alongside the budget proposals.

CAPITAL EXPENDITURE

	2021/22 Probable £'000
Non Housing	77,946
Housing	19,876
Total	**97,822**

4.6 The net decrease of **£36.183m** in the planned Non Housing capital expenditure during 2021/22 is mainly attributable to re-profiling of expenditure to 2022-23 and beyond as a result of the delays to capital work largely as a result of the effects of Covid-19 pandemic in terms of contracts being signed later than anticipated and longer delivery times for raw materials. The full net effect of the decrease is a result of the following factors:

(i) The change in the cash flow profile of a number of programmes resulting in a net adjustment of £47.858m from 2021/22 into 2022/23 and future years as reported to relevant policy boards.

(ii) Carry forward of programmed expenditure from 2021/22 to 2010/21 totalling £9.739m.

(iii) The addition of £2.165m funding for projects approved during 2021/22.

4.7 The decrease of **£5.726m** in the planned Housing capital expenditure during 2021/22 arises from the net effect of:-

(i) Expenditure brought forward from 2020/21 into 2021/22 of £0.664m.

(ii) The change in the cash flow profile of a number of programmes resulting in a net adjustment of £6.390m from 2021/22 into 2022/23 and future years as reported to the Communities, Housing & Planning Policy Board. The majority of this relates to planned work on existing properties which is taking longer to complete due to Covid-19 guidance over the access of properties.

5 CAPITAL FINANCING REQUIREMENT INDICATOR

5.1 *Capital Financing Requirement*: The Council has available to it a number of ways of financing traditionally procured capital investment. The term “financing” does not refer to the payment of cash, but the resources that are applied to ensure that any underlying amount arising from capital payments is dealt with absolutely, whether at the point of spend or over the longer term. A number of financing options involve resourcing the investment at the time that it is incurred. These are:

- Application of useable capital receipts
- A direct charge to revenue for capital expenditure

- The application of capital grants
- Up-front contributions from project partners

5.2 Capital expenditure which is not financed up front by one of the above methods will increase the Capital Financing Requirement of the Council.

5.3 Members approved the following as the indicator for the Capital Financing Requirement at the end of each of the next three years at the Council meeting on 4th March 2021:

CAPITAL FINANCING REQUIREMENT			
	31/03/2022 Estimate £m	**31/03/2023 Estimate £m**	**31/03/2024 Estimate £m**
Non Housing	341	431	467
Housing	119	149	188
Total	**460**	**580**	**655**

5.4 The revised projected capital financing requirement for 2021/22, based on the position at 15th October 2021 is noted in the table below. The 2022/23 & 2023/24 requirements will be reviewed in March 2022 alongside the budget proposals;

CAPITAL FINANCING REQUIREMENT	
	31/03/2022 Probable £m
Non Housing	268
Housing	107
Total	**375**

5.5 The decrease of £73 million in the probable Capital Financing Requirement at 31st March 2022 in Non Housing services arises from:

(i) The reduced capital expenditure forecast to the end of 2021/22 described in 4.6.

(ii) Accelerated repayment of General Fund loans made during 2020/21 in line with the Council's approved debt smoothing strategy

(iii) Grant received from Scottish Government in 2020/21 in relation to City Deal projects.

5.6 The decrease of £12 million in the probable Capital Financing Requirement at 31st March 2022 in Housing services is a result of the reduced capital expenditure in 2021/22 described in 4.7 and accelerated HRA loan repayments made during 2020/21.

6 EXTERNAL DEBT INDICATORS

6.1 External debt is referred to as the sum of external borrowing and other long term liabilities (e.g. covenants). The prudential indicators for external debt are set and revised taking into account their affordability. It is through this means that the objective of ensuring that external debt is kept within sustainable prudent limits is addressed year on year.

6.2 External debt indicators are set at two levels: an *operational boundary* and an *authorised limit*. Both of these need to be consistent with the Council's plans for capital expenditure and financing and with its treasury management policy statement and practices.

6.3 *Operational Boundary:* This is the focus of day-to-day treasury management activity within the Council, and is an estimate of the most likely scenario in terms of cash flow. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the Capital Financial Requirement and estimates of cashflow requirements for **all** purposes. It is possible that this boundary could be breached occasionally and this should not be regarded as significant. However, a sustained or regular trend would require investigation and action.

6.4 The Council has set for the current financial year and following two years an Operational Boundary for its total external debt, identifying separately borrowing from other long term liabilities.

OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

	31/03/2022 Estimate £m	31/03/2023 Estimate £m	31/03/2024 Estimate £m
Borrowing	390	514	593
Other long-term liabiliites	70	66	62
Total	**460**	**580**	**655**

6.5 The probable outturn for the current financial year is anticipated at £375 million, a decrease in the Operational Boundary of £85 million. This is mainly as a result of the reduced Capital Finance Requirement due to lower capital expenditure for both Housing and Non-Housing Services outlined in paragraphs 5.5 and 5.6. There have been no breaches during the period from 1st April to 15th October which have required action. The 2022/23 and 2023/24 operational boundary will be reviewed in March 2022 alongside the budget proposals.

OPERATIONAL BOUNDARY FOR EXTERNAL DEBT	31/03/2022 Probable £m
Borrowing	303
Other long-term liabilities	72
Total	**375**

6.6 *Authorised Limit*: This is based on the same assumptions as the Operational Boundary, with sufficient "headroom" to allow for unusual/exceptional cash movements. Headroom of approximately 5% has been added to the Operational Boundary to arrive at an authorised limit which is sufficient to allow for cash flow management without breaching the limit.

6.7 The Council has set for the forthcoming financial year and following two years an Authorised Limit for its total external debt, but identifying separately borrowing from other long term liabilities.

AUTHORISED LIMIT FOR EXTERNAL DEBT	31/03/2022 Estimate £m	31/03/2023 Estimate £m	31/03/2024 Estimate £m
Borrowing	410	540	623
Other long-term liabiliites	70	66	62
Total	**480**	**606**	**685**

6.8 The revised anticipated authorised limit for this financial year is projected at £4390 million, a decrease of £90 million to the estimate and in line with the operational boundary reduction as outlined in 6.5. The authorised limit will be reviewed on an annual basis and any changes will require approval by Council.

AUTHORISED LIMIT FOR EXTERNAL DEBT	31/03/2022 Probable £m
Borrowing	318
Other long-term liabilities	72
Total	**390**

6.9 In December 2018 the CIPFA/LASAAC Local Authority Accounting Board confirmed that from 1st April 2020 the CIPFA Code of Practice on Local Authority Accounting would be adopting the accounting standard IFRS 16 Leases. This was extended to 1st April 2022 as result of the Covid-19 pandemic.

The practical effect of adopting IFRS 16 will be to require any contract the Council has signed which provides the right to rent or lease exclusive use of an asset, such as property or vehicles, could potentially require to be recognised as an asset on the Council's balance sheet with a corresponding debt liability recognised at the present value of the future lease payments. This liability will be treated as additional borrowing, therefore, increasing the Capital Financing Requirement and other associated Prudential Indicators such as Operational Boundary, Authorised Limit and Revenue to Financing Cost ratios. A full review of all contracts that could be impacted by this is currently under way and will be factored into future Prudential Indicators once the full effect is known.

7 LOAN FUND ADVANCES

7.1 Loans fund accounting arrangements are governed by the provisions set in the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

7.2 Repayment of loans fund advances are required to be made in line with the Scottish Government's statutory Guidance on Loans Fund Accounting.

7.3 The aim of prudent repayment is to ensure that the Council's net capital expenditure is financed over a period of years in which that expenditure is expected to provide a benefit and that the repayment each year is reasonably commensurate with the period and pattern of benefits. Housing and Non-Housing advances and associated annual repayments are identified separately.

7.4 Members approved the 2021/22 policy on loan fund repayments on the 4th March 2021. Statutory guidance requires the policy to be approved each year and the 2022/23 policy will be reviewed in March 2022 alongside the budget proposals.

7.5 The Council's current policy is as follows:

Asset Life Method: Loans fund advances will be repaid with reference to the life of an asset using an average life of 40 years for General Fund assets and 30 year for HRA assets, with an annuity rate of 6.00%

Assets constructed under City Deal arrangements will have differing asset lives and loans fund repayments will be over 60 years at the asset life method. This will ensure that the repayments are reasonably commensurate with that over which the assets will provide benefits.

7.6 The Council's latest estimates of its loan fund account information are as follows:

Year	Opening Balance £m	Advances to GF £m	Advances to HRA £m	Repayment by GF £m	Repayment to GF by City Deal Grant £m	Repayment by HRA £m	Closing Balance £m
2020-21 actual	298	5	7	(8)	(10)	(19)	273
2021/22	273	31	15	-	(3)	(13)	303
2022/23 - 26/27	303	213	70	(4)	(9)	(45)	528
2027/28 - 31/32	528	-	-	(20)	(24)	(23)	461
2032/33 -36/37	461	-	-	(37)	(25)	(22)	377
2037/38 -41/42	377	-	-	(44)	-	(20)	313
2042/43 - 46/47	313	-	-	(47)	-	(23)	243
2047/48 - 51/52	243	-	-	(40)	-	(30)	173
2052/53 -56/57	173	-	-	(57)	-	(12)	104
2057/58 -61/62	104	-	-	(63)	-	(2)	39
2062/63 - 66/67	39	-	-	(17)	-	-	22
2067/68 - 71/72	22	-	-	(4)	-	-	18
2072/73 - 76/77	18	-	-	(5)	-	-	13
2077/78 - 81/82	13	-	-	(6)	-	-	7
2082/83 - 86/87	7	-	-	(7)	-	-	-

7.7 On 10th March 2021 the Scottish Government issued an amendment to the Local Authority (Capital Finance & Accounting) Regulations with the Local Authority (Capital Finance & Accounting) (Scotland) (Coronavirus) Amendment Regulations 2021.

7.8 The amendment permits a Local Authority to reduce loan fund repayments to an amount not less than zero for the 2021-22 financial year. The table above assumes this option will not be exercised for Non-Housing repayments in 2021-22 due to the very limited benefit of exercising the option.

8 TREASURY MANAGEMENT INDICATORS

8.1 The prudential indicator in respect of treasury management is that the local authority has adopted CIPFA *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (*the "Treasury Management Code").

8.2 Compliance with the Treasury Management Code requires a mid-year review of Treasury Management activity. This was reported to Finance, Resources and Customer Services Policy Board on 10th November 2021.

9 INDICATORS FOR AFFORDABILITY

9.1 A key measure of affordability is the incremental impact of investment decisions on the council tax or house rents. Estimates of the ratio of financing costs to net revenue stream provide an indication of how much of the Council's revenue is committed to the repayment of debt.

9.2 As reported to Council on 4th March 2021 the ratios for the next 3 years are shown in the table below:

RATIO OF FINANCING COSTS TO NET REVENUE STREAM			
	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Non Housing	3.31%	3.96%	4.67%
Housing	42.14%	38.40%	36.13%

9.3 The revised ratios for 2021/22, based on the position at 15th October 2021 is noted in the table below. The 2022/23 & 2023/24 requirements will be reviewed in March 2022 alongside the budget proposals;

RATIO OF FINANCING COSTS TO NET REVENUE STREAM	
	31/03/2021 Probable
Non Housing	3.92%
Housing	39.91%

Implications of the Report

1. **Financial** – Prudential indicators are being monitored by the Director of Finance and Resources throughout the year. They are based directly on the Council's Capital and Revenue budgets, as detailed in the other reports considered by the Council on 4th March 2021 and reported to the Council's Policy Boards on a regular basis.

2. **HR & Organisational Development** – None

3. **Community/Council Planning** – None

4. **Legal** – None

5. **Property/Assets** – None

6. **Information Technology** – None

7. **Equality & Human Rights** -

   (a) The Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** - None

9. **Procurement** - None

10. **Risk** - None

11. **Privacy Impact** – None

12. **Climate Risk** – None

13. **Cosla Policy Position** – None

List of Background Papers

(a) Non-Housing Capital Investment Programme 2021/22 – 2025/26, Appendix 6: Prudential Framework for Capital Finance 2021-2024 (estimates) and Treasury Management Strategy Statement 2021-24. Council, 4th March 2021.

(b) Treasury Management Mid-Year Review 2021/22. Finance, Resources and Customer Services Policy Board, 10th November 2021.

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