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**To:** Council

**On:** 15 December 2022

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**Report by:** Director of Finance & Resources

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**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 2022/23 on 3 March 2022. The purpose of this report is to consider the indicators as they stand at 14 October 2022, approximately halfway through the financial year, and revise them where 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.

3.3 The prudential indicators required by the Code are specifically designed to support 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. Any resulting changes to the Code will be incorporated into 2023/23 Prudential Indicators for Council approval in March 2023.

## **4 Capital Expenditure Indicators**

4.1 The Council has a duty to determine and keep under review the maximum amount 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 3 March 2022, and 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:-

<b>CAPITAL EXPENDITURE</b>			
	<b>2022/23 Estimate £000</b>	<b>2023/24 Estimate £000</b>	<b>2024/25 Estimate £000</b>
Non-Housing*	131,756	174,617	82,044
Housing	29,995	53,227	67,747
<b>Total</b>	<b>161,751</b>	<b>227,844</b>	<b>149,791</b>

*\*The 2022/23 Non-Housing estimate excludes the estimated expenditure in relation to the Private Sector Housing Grant.*

4.4 Total capital expenditure to 14 October 2022 was £36.629m, of which £30.754m relates to Non-Housing and £5.876m relates to Housing.

4.5 A review of the forecast capital spending for 2022/23 suggests that the indicators need to be revised as follows for the current year. Indicators for 2023/24 and 2024/25 will be reviewed in March 2023 alongside the budget proposals.

<b>CAPITAL EXPENDITURE</b>	
	<b>2022/23 Probable £000</b>
Non-Housing	113,043
Housing	21,507
<b>Total</b>	<b>134,550</b>

4.6 The decrease of **£18.713m** in the planned Non-Housing capital expenditure during 2022/23 is mainly attributable to:

- The change in the cashflow profile of a number of programmes, resulting in a net adjustment of £36.993m from 2022/23 into 2023/24 and future years, as reported to relevant policy boards;
- Carry forward of programmed expenditure from 2021/22 to 2022/23 totalling £11.135m; and
- The addition of £7.145m funding for projects approved during 2022/23.

- 4.7 The decrease of **£8.488m** in the planned Housing capital expenditure during 2022/23 arises from the change in the cashflow profile of a number of programmes resulting in a net adjustment of £8.488m from 2021/22 into 2022/23 and future years as reported to the Communities, Housing & Planning Policy Board.

## 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 3 March 2022:

<b>CAPITAL FINANCING REQUIREMENT</b>			
	<b>31/03/2023 Estimate £m</b>	<b>31/03/2024 Estimate £m</b>	<b>31/03/2025 Estimate £m</b>
Non-Housing	364	442	467
Housing	122	160	211
<b>Total</b>	<b>486</b>	<b>602</b>	<b>678</b>

- 5.4 The revised projected capital financing requirement for 2022/23, based on the position at 14 October 2022 is noted in the table below. The 2023/24 and 2024/25 requirements will be reviewed in March 2023 alongside the budget proposals for 2023/24 and beyond.

<b>CAPITAL FINANCING REQUIREMENT</b>	
	<b>31/03/2023 Probable £m</b>
Non-Housing	352
Housing	110
<b>Total</b>	<b>462</b>

5.5 The decrease of £12 million in the probable Capital Financing Requirement at 31st March 2023 in Non-Housing services arises from the reduced capital expenditure forecast to the end of 2022/23 described in 4.6, partly offset by an increase in other liabilities in relation to new service concession flexibility arrangements. These were announced by the Scottish Government in September 2022 and the impact for Renfrewshire Council is explained in section 10.

5.6 The decrease of £12 million in the probable Capital Financing Requirement at 31 March 2023 in Housing arises from:

- The reduced capital expenditure forecast to the end of 2022/23 described in 4.7; and
- An accelerated repayment from the HRA to the loans fund in 2021/22 in order to smooth future loan fund repayments.

## 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 cashflow. 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 would 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.

<b>OPERATIONAL BOUNDARY FOR EXTERNAL DEBT</b>			
	<b>31/03/2023 Estimate £m</b>	<b>31/03/2024 Estimate £m</b>	<b>31/03/2025 Estimate £m</b>
Borrowing	408	528	607
Other long-term liabilities	78	74	71
<b>Total</b>	<b>486</b>	<b>602</b>	<b>678</b>

6.5 The probable outturn for the current financial year is anticipated at £462 million, a decrease in the Operational Boundary of £24 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 above, offset by the increase in revised service concession liabilities. There have been no breaches during the period from 1 April to 14 October that have required action. The 2022/23 and 2023/24 Operational Boundary will be reviewed in March 2023 alongside the budget proposals.

<b>OPERATIONAL BOUNDARY FOR EXTERNAL DEBT</b>	
	<b>31/03/2023 Probable £m</b>
Borrowing	366
Other long-term liabilities	96
<b>Total</b>	<b>462</b>

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 cashflow 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.

<b>AUTHORISED LIMIT FOR EXTERNAL DEBT</b>			
	<b>31/03/2023 Estimate £m</b>	<b>31/03/2024 Estimate £m</b>	<b>31/03/2025 Estimate £m</b>
Borrowing	428	554	637
Other long-term liabilities	78	74	71
<b>Total</b>	<b>506</b>	<b>628</b>	<b>708</b>

6.8 The revised anticipated authorised limit for this financial year is projected at £481 million, a decrease of £25 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.

<b>AUTHORISED LIMIT FOR EXTERNAL DEBT</b>	
	<b>31/03/2023 Probable £m</b>
Borrowing	385
Other long-term liabilities	95
<b>Total</b>	<b>480</b>

6.9 In December 2018 the CIPFA/LASAAC Local Authority Accounting Board confirmed that from 1 April 2020 the CIPFA Code of Practice on Local Authority Accounting would be adopting the accounting standard IFRS 16 Leases.

After consultation, in April 2022 the deadline for implementation of IFRS was extend to 1 April 2024 due to significant delays as a result of the Covid-19 pandemic. However, the Code will allow authorities to adopt IFRS 16 on 1 April 2022 or 1 April 2023.

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. The Council is likely to adopt IFRS 16 during 2023/24.

## **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 2022/23 policy on loan fund repayments on 3 March 2022. Statutory guidance requires the policy to be approved each year and the 2023/24 policy will be reviewed in March 2023 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 years 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
2021-22 actual	273	19	13	-	-	(16)	289
2022/23	289	70	19	-	-	(11)	367
2023/24 - 27/28	367	196	216	(7)	(4)	(40)	728
2028/29 - 32/33	728	-	-	(18)	(38)	(36)	636
2033/34 -37/38	636	-	-	(38)	(25)	(39)	534
2038/39 -42/43	534	-	-	(48)	-	(43)	443
2043/44 - 47/48	443	-	-	(52)	-	(56)	335
2048/49 - 52/53	335	-	-	(42)	-	(72)	221
2053/54 -57/58	221	-	-	(72)	-	(39)	110
2058/59 -62/63	110	-	-	(71)	-	(2)	37
2063/64 - 67/68	37	-	-	(18)	-	-	19
2068/69 - 72/73	19	-	-	(4)	-	-	15
2073/78 - 77/78	15	-	-	(5)	-	-	10
2078/79 - 82/83	10	-	-	(6)	-	-	4
2083/84 - 87/88	4	-	-	(1)	-	-	-

## 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 17 November 2022.

## 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 3 March 2022 the ratios for the next 3 years are shown in the table below:

<b>RATIO OF FINANCING COSTS TO NET REVENUE STREAM</b>			
	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>
Non-Housing	3.47%	3.62%	3.48%
Housing	34.16%	30.10%	30.12%

- 9.3 The revised ratios for 2022/23, based on the position at 14 October 2022 is noted in the table below. The 2023/24 and 2024/25 requirements will be reviewed in March 2023 alongside the budget proposals;

<b>RATIO OF FINANCING COSTS TO NET REVENUE STREAM</b>	
	<b>31/03/2023 Probable</b>
Non-Housing	3.22%
Housing	33.44%

## **10 Service Concession Flexibility**

- 10.1 The term 'service concession' relates to a type of finance lease arrangement whereby annual contract payments (such as the unitary charge for PPP schools) are subject to accounting disclosure in the annual accounts that splits the full cost into different elements, being:
- Rental element, for occupying the asset;
  - Service charge element, for servicing the asset;
  - Interest element, to pay interest on the financing of the asset;
  - Lease principal (capital) element, to repay debt on the financing of the asset, spread over the life of the contract.
- 10.2 In September 2022, the Scottish Government published Finance Circular 10/2022, which sets out a new accounting flexibility for local authorities who have service concession arrangements dated prior to 1 April 2022, that allows this last element to be spread over the life of the asset, rather than the life of the contract.
- 10.3 Renfrewshire Council's PPP schools contract was established in 2006 and its term is 32 years. The capital element is spread on an annuity basis using the contractual interest rate of 7.65%.

The Council treats other school assets as having an expected useful life of 40 years, and therefore, as previously agreed by Council, the flexibility permitted under the Finance Circular will be employed from the 2022/23 financial year.

- 10.4 This revised accounting methodology will provide support to the Council's medium-term financial position, with increased costs over the useful life of the asset being incorporated into the Council's longer term financial planning arrangements.

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### 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 other reports considered by the Council on 3 March 2022 and reported to the Council's Policy Boards on a regular basis.
  2. **HR & Organisational Development** – None arising directly from this report
  3. **Community/Council Planning** – None arising directly from this report
  4. **Legal** – None arising directly from this report
  5. **Property/Assets** – None arising directly from this report
  6. **Information Technology** – None arising directly from this report
  7. **Equality & Human Rights** – None arising directly from this report
  8. **Health & Safety** - None arising directly from this report
  9. **Procurement** - None arising directly from this report
  10. **Risk** - None arising directly from this report
  11. **Privacy Impact** – None arising directly from this report
  12. **Climate Risk** – None arising directly from this report
  13. **Cosla Policy Position** – None arising directly from this report
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## **List of Background Papers**

Non-Housing Capital Investment Programme 2022/23 – 2026/27, Appendix 6: Prudential Framework for Capital Finance 2022-2025 (estimates) and Treasury Management Strategy Statement 2022-25. Council, 3 March 2022.

Treasury Management Mid-Year Review 2022/32. Finance, Resources and Customer Services Policy Board, 17 November 2022.

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