Appendix A

Prudential Indicators – Methodology

1 Background and Information

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when setting and reviewing their Prudential Indicators.

The Prudential Code imposes on local authorities clear governance procedures for setting and revising of prudential indicators, and describes the matters to which an authority will 'have regard' when doing so. This is designed to deliver accountability in taking capital financing, borrowing and treasury management decisions.

The Prudential Indicators required by the Prudential Code are designed to support and record local decision making and not as comparative performance indicators.

A number of treasury indicators which previously formed part of the Prudential Code are now contained within the Treasury Management Code and Guidance. Local authorities are still required to 'have regard' for these indicators.

2 Basis of Methodology

1. Estimates of Capital Expenditure

The estimates of the Council's future capital expenditure levels (and the HRA) underpin the calculation of the other prudential indicators. The capital expenditure estimates are based on a projection of future levels of capital resources/ allocation.

Estimates of capital expenditure are a significant source of risk and uncertainty and it is important that these estimates are continually monitored and the impact on other prudential indicators (particularly those relating to affordability) assessed regularly.

2. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs.

3. Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlining need to borrow for capital purpose, i.e. its borrowing requirement. The CFR is the amount of capital expenditure that has not yet been financed by capital receipts, capital grants or contributions from revenue.

4. Incremental impact of new capital investment decisions on Council tax / Housing rents

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

5. Authorised limit

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. excluding investments) for the Council. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimated debt with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under the Local Government Act 2003 and must not be exceeded during the year.

6. Operational Boundary for External Debt

This indicator refers to the means by which the authority manages its external debt to ensure it remains within the statutory authorised limit. It differs from the authorised limit in as far as it is based on the most likely scenario, in terms of capital spend and financing during the year.

The operational boundary limit comprises the Council's existing debt plus the most likely estimate of capital expenditure/financing for the year. It excludes any projections for cash flow movements. Unlike the authorised limit breaches of the operational boundary (due to cash flow movements) are allowed during the year as long as they are not sustained over a period of time.

7. Adoption of the CIPFA TM Code

This indicator is acknowledgment that the local authority has adopted the CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*.

8. Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget.

The limits adopted by Council provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

9. Maturity Structure of Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, thereby managing the effects of refinancing risks.

The maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment.

10. Maximum Principal Sums invested for more than 364 days

This indicator sets an upper limit for the level of investment that may be fixed for a period greater than 364 days. This limit is set to contain exposure to credit and liquidity risk.

11. Gross Debt and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

Where **the gross debt is greater than the capital financing requirement the reasons** for this should be clearly stated in the annual treasury management strategy.