

## Appendix B

### PRUDENTIAL FUNDING STATEMENT

- 1 This statement has been prepared in accordance with the CIPFA Code of Practice "Treasury Management in Local Authorities" which is re-adopted each year by Members of the Authority. The statement and its implementation is reviewed and updated twice annually in the final accounts and budget reports.
- 2 The Local Government Act 2003 and Local Authorities (Capital Finance and Accounting) Regulations 2003 set out the system of capital finance to be followed by all local authorities from 1 April 2004. This appendix is intended to take account of the requirements of the regulations and to set them in the context of the Treasury Management code of practice.

### Treasury Management Activity - Borrowing

	£m	£m
<b>Total Loans outstanding at 1/4/2005:</b>		
Interest: Fixed (incl LOBOs)	90.0	
Variable	0.0	
Temporary (net of Investments)	4.5	94.5
Activity expected during 2005/06:		
Loan repayments	-4.5	
New temporary loans	5.0	
New borrowing	15.0	15.5
<b>Anticipated loans outstanding at 31/3/2006:</b>		<b>110.0</b>
Activity expected during 2006/07		
New borrowing	5.0	
Debt repayments	0.0	5.0
<b>Anticipated loans outstanding at 31/3/2007:</b>		<b>115.0</b>

### Comment:

- 3 The Bank of England's base rate started the year at 4.75% but reduced on 4 August 2005 to 4.5% where it has remained. As usual, on the financial markets both short term and long term borrowing and investment rates have fluctuated due to the volatile situation in the world's economies. For the first time for many years, due to a gilt rally on the market, rates fell below the 5% level and have recently fallen below 4% although it is unclear how long this rally can continue. Action was therefore taken to borrow £5m as part of the loan requirement for 2006/07.
- 4 To minimize risk to the Authority the funds borrowed in advance of need were lent out at a rate of 4.56%. This is in excess of the rate at which they were borrowed.
- 5 Leeds City Council has been monitoring the financial markets on behalf of the Authority with a view to continuing the policy of refinancing some of the Authority's longer term loans if rates appear advantageous. Two recent

transactions firstly allowed a PWLB loan to be rescheduled for a slightly lower interest rate plus a discount and secondly to reschedule a LOBO to provide an improved interest profile plus a slightly lower interest rate. The loan portfolio in relation to the market is being kept under constant review.

- 6 The Authority's net borrowings in 2005/06 closely followed the financing requirements shown in the prudential statement below although as stated an advance loan of £5m has been obtained thus reducing the 2006/07 borrowing requirement. The annual interest rate for the Authority's external debt at 31 March 2005 was 4.62% (anticipated to be 4.59% at 31 March 2006) which is significantly lower than the rate at which the districts attract support from the government in FSS (ie 6.3% for 2005/06 and 6.0% for 2006/07). Since the Authority average is currently similar to available PWLB borrowing rates it is unlikely that significant further reductions can be made unless market rates also fall.
- 7 Members will be aware of the fraud by a member of the City Council's staff. New staff have taken over the borrowing and investment function on behalf of this Authority and additional controls put in place. Regular management meetings are being held with the staff concerned who also monitor the market on behalf of Leeds. Whilst the fraud has cost the Authority in terms of lost cash the level concerned is very significantly below the benefits referred to in the previous paragraph. The transition to new staff has been effective and it is anticipated that the improved level of performance will continue.
- 8 The market position of interest rates continues to be monitored on a daily basis to ensure longer term loans are only obtained where interest rates are competitive. It is considered unlikely any further refinancing of existing loans will be undertaken in the near future although the situation will be kept under review.
- 9 The current forecast of base rate is for it to fall to 4.25% or even 4% in 2006 but to rise again by early 2007.

#### **Treasury Management Activity - Investments Criteria**

- 10 In general there are to be no long term loans by the Authority although surplus cash will be invested for up to one year. There was one short term investment of £5m at 1st April 2005. This was because of the current policy of operating the financing on a short term basis to minimise both investments and income to avoid taking out expensive loans and re-lending them at a lower rate of interest. As previously stated the latest loan has been relent. This was for 364 days at a marginally higher rate than it was borrowed for. The level of future investments will fluctuate on a short-term basis due to cash flow requirements, but is likely to remain low.
- 11 It is proposed that the existing policy of utilising the expertise of the Treasury Management Team in Leeds City Council be reaffirmed for 2005/06, and for future years, the following rules for short term investments/borrowing be applied:-

- a. The Chief Financial Officer shall determine the amounts and periods.
- b. The procedural document as approved for their Treasury Management Division by Leeds City Council shall be adopted in relation to the Authority's short-term investments encompassing the Council's list of approved financial organisations and the maximum lending limits per organisation, as specified in that document from time to time.
- c. No investment will be for a period exceeding 12 months.
- d. In principle there shall be no cross borrowing or investments with Leeds City Council (although this may be varied if late cash movements on the bank account occur creating a surplus/deficit cash position after the markets have closed for the day).

### **Prudential funding arrangements**

- 12 The principal purpose of the prudential system is to allow authorities as much financial freedom as possible whilst requiring them to act prudently. There will be no government borrowing approvals issued but restrictions are imposed through the CIPFA Prudential Code which requires every authority to set prudential indicators and limits and thus be satisfied that it can afford the results of its borrowing. These limits, which must not be exceeded, have to be formally agreed by the authority before the start of each financial year. The government has retained the power, if it so wishes to limit the level of borrowing incurred by authorities.
- 13 The Code requires full capital and revenue plans to be prepared for at least 3 years forward in order to assess the financial effects of the planned capital investment. In this Authority the three year financial strategy was considered by Members last December and to ensure a level of affordability it is currently the policy that borrowing to meet capital expenditure will be limited to existing levels plus any SCE(R) issued by the government through the LTP settlement either for Integrated Transport or for specific major schemes. Restricting borrowing in this way ensures that all debt charges are covered by the additional RSG received by the District Councils and hence within the Levy, providing the Levy has been increased to reflect the additional RSG.
- 14 The draft three year capital programme is attached as an Annex to this statement. This is in outline only and each individual scheme will be reported to Members for approval before work commences. It should be noted that in accordance with the above, whilst there has been some deliberate over-programming to ensure expenditure achieves the LTP settlement, overall capital expenditure will be met firstly by grants and other resources leaving the balance to be met by borrowing. The programme assumes there is to be no unsupported borrowing outside the LTP.
- 15 Since the levels of SCE(R) granted to the Authority under the LTP are significantly below those required to fully implement the draft capital

programme it is proposed to examine alternative methods of financing during the year to assist with the possible shortfall. As an example leasing might be used for the acquisition of assets such as Accessbuses. The financial viability of such methods will require investigation and savings found within the budget to accommodate the costs involved. Members will be asked to approve any such methods before they are implemented.

- 16 Other matters which Members should be aware of relating to this Authority's operation of the Prudential regulations are that:
- a. It is not proposed that the Authority enter into any credit arrangements as defined by the regulations, other than possibly leasing as described above. Should any such arrangements be required they will be reported to members in advance and will be expected to be funded within the approved strategy.
  - b. The PTE is being treated as part of the PTA for the purposes of the capital financing arrangements. (Section 18 of the Act)
  - c. Due to the advance borrowing of the £5m for 2006/07 one of the parameters of the maturity of the loan structure (ie that long term loans should not exceed 90% of the portfolio) was exceeded for a short period and it is proposed to reset this parameter for the future to 100% as it reduces rather than increases the Authority's risk level on interest rates.
  - d. It should also be noted that for a period of a few days the operational boundary was exceeded to allow a replacement borrowing to take place a few days before the previous loan was repaid. This allowed the treasury team to maximize the discount on the repayment whilst minimizing the future interest rate.
- 17 The attached Annex shows the calculation of the following prudential indicators:
- The ratio of debt charges to overall expenditure which is not significant to this Authority as it is effectively controlled through the level of the Levy (as referred to above)
  - Setting the borrowing requirement for the year (similar to total loans outstanding) but called the 'the operational boundary'
  - Setting the maximum borrowing permitted in the year defined as 'the authorised limit'. This is about £10m higher than the operational boundary to create flexibility to allow temporary additional borrowing (for example if it becomes prudent to borrow in advance of normal requirements because long term interest rates are low).
  - Setting the maturity loan structure which is defined as "amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate"
- as well as the draft capital programme. These are set out in the annex.

- 18 Prudential Code requires Members to have an approved Treasury Management Policy (This is set out above) and to agree limits for variable and fixed rate loans. It is recommended that the maximum limit for variable rate loans be set at 40% and the limit for fixed rate loans be 100%. Apart from the matters referred to in para 16 these limits have not been breached during 2005/06 and should allow for any future fluctuations in interest rates occurring in the money market.

## **RECOMMENDATIONS**

- (i) That the adoption of the CIPFA Code of Practice for Treasury Management in Public Services be reaffirmed.
- (ii) That the Treasury Management policy as set out above and in the Annex be approved.
- (iii) That the overall capital programme and prudential limits for the next 3 years set out in the Annex be adopted as follows:
  - i. Operational boundary as shown
  - ii. Authorised Limit (Operational boundary plus £10m)
  - iii. Maturity Loan structure as shown
  - iv. A variable rate loan limit of 40%
  - v. A fixed rate loan limit of 100%
- (iv) That the short-term investment criteria be approved.