NORTH LONDON WASTE AUTHORITY **AGENDA ITEM NO**

REPORT TITLE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES	
REPORT OF FINANCIAL ADVISER	
FOR SUBMISSION TO AUTHORITY MEETING	**DATE** 11 FEBRUARY 2004
1. **SUMMARY OF REPORT** The Local Government Act 2003 abolishes the existing system of capital controls for local authorities and introduces a framework for a new system of prudential borrowing. This report provides a summary of the key objectives of the Prudential Code that comes into effect on 1 April 2004 and comments on the implications for the Authority.	
2. **RECOMMENDATIONS** The Authority is requested to:- (i) Note the requirements of the new system of prudential borrowing. (ii) Approve the amendments to the Authority's Financial Standing Orders set out at paragraph 11. (iii) Approve the Prudential Indicators set out at paragraph 12.	
Signed by the Financial Adviser: …………………………………………………………. Date: ………………………………………………………….	

3. **Background**

3.1 Members will be aware that in December 1994 the Authority complied with the requirements of the Environmental Protection Act 1990 and divested itself of its waste disposal operations. As a consequence it has not been necessary for the NLWA to agree a capital programme for the past ten years. Capital receipts arising from the formation of the joint venture company with Sita UK and the first payment for land acquired by the Highways Agency have therefore been distributed to constituent councils. The Authority currently holds capital receipts of £0.621m (disposal of land at Tilling Road and a property in Picketts Lock Lane) and is due to receive a further payment from the Highways Agency for land that the Agency acquired in 1993 under a CPO for the expansion of the North Circular at Edmonton.

3.2 Although the 2004/05 revenue budget presented elsewhere on this agenda continues to assume that there is at present no need for a capital budget in 2004/05, the position may well change in future years as the Authority and its constituent councils begin to address the implementation of the Joint Waste Strategy. It is currently envisaged that the Authority will take the lead in providing/arranging for the provision of new facilities. The strategy is due to be submitted to the London Mayor for approval in September 2004.

3.3 Consideration of the Prudential Code Regime is therefore likely to be particularly relevant for the Authority in the future. The Code will however have some limited relevance for 2004/05 in that it will be necessary for the Authority apply the Code in respect of the Arsenal Football Club's proposals for the replacement of the Ashburton Grove waste transfer station. The proposed 999-year leases for the new facility count as a credit arrangement.

3.4 This report therefore provides:

(i) An outline of the main objectives of the new Prudential Code,
(ii) Identifies the changes that are required to the Authority's Financial Standing Orders,
(iii) Identifies the prudential indicators for approval at this meeting.

4. The Prudential Code

4.1 The Local Government Act 2003 received Royal Assent on 18 September 2003. The Act abolishes the existing system of capital controls for local authorities and introduces the framework for the new system of prudential borrowing. This enables authorities to set their own borrowing limits subject to what is prudent, affordable, and sustainable. The decision as to what is prudent, affordable, and sustainable must be taken with the advice of the Financial Adviser. In practice the Authority does not receive revenue support towards capital expenditure (this is received by constituent councils), so any new borrowing in the future will only be possible if it can be met by obtaining additional revenue resources through the levy, savings or from potential future dividend payments from LondonWaste Ltd (once the costs of meeting the Waste Incineration Directive have been met).

4.2 The Prudential Code was developed by the Chartered Institute of Public Finance and Accountancy (CIPFA), as a professional code of practice to support local authorities in taking their decisions to determine capital investment in fixed assets that are central to the delivery of quality public services. Local authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

5. Prudential Code Requirements

5.1 The Regulations make reference to the need to have regard to the CIPFA Prudential Code. The Code contains more detailed information about the matters that authorities need to consider in the new regime and it is appropriate to consider these more closely.

5.2 The objectives of the Code are, in essence, to ensure that local authorities only embark on capital investment plans that are **affordable**, **prudent** and **sustainable**. At the same time the Code has the objective of being consistent with and supporting local strategic plans, local asset management planning and proper option appraisal.

5.3 To demonstrate that authorities have fulfilled these objectives the Code sets out a number of indicators that must be used in decision-making as well as other factors that must be taken into account. A list of these indicators is given at paragraph 12 below.

5.4 It is important to understand that these indicators are not designed to be comparative performance indicators and as CIPFA clearly points out the use of them in this way would be likely to be misleading and counter productive as each authority’s debt profile reflects it’s own unique requirements and policies.

5.5 The Code sets out a clear governance procedure for the setting and revising of Prudential Indicators. The Financial Adviser will be responsible for ensuring that all matters required to be taken into account are reported to the Authority for consideration, and for establishing procedures to monitor actual performance against the indicators.

5.6 In setting or revising the prudential indicators the Authority must have regard to the following matters:-

- Affordability (e.g. implications for the levy)
- Prudence and Sustainability (e.g. implications for external borrowing)
- Value for Money (e.g. option appraisal)
- Stewardship of Assets (e.g. asset management planning)
- Service Objectives (e.g. strategic planning for the authority)
- Practicality (e.g. achievability of the forward financial plan)

6. Affordability

6.1 The fundamental objective when considering affordability of the Authority's capital plans is to ensure that total capital investment remains within sustainable limits, and in particular to consider its impact on the local authority. Affordability is ultimately determined by a judgement about acceptable levy levels.

6.2 The Authority must consider all of the resources currently available to it and those estimated for the future, together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the following two years. Known significant variations beyond this time frame must also be considered. This requires local authorities to have rolling three-year revenue forecasts as well as rolling three-year capital expenditure plans.

6.3 The Code requires that when considering affordability the Authority must also pay due regard to risk and uncertainty. Risk analysis should therefore be undertaken and risk management strategies should also be considered.

6.4 The Authority must set two limits for external debt i.e. an "authorised limit" and an "operational boundary". These must be consistent with the Authority's plans for capital expenditure and financing; and with its Treasury Management Policy Statement and Practices. The Authority's Financial Standing Orders state that unless otherwise agreed by the Authority that treasury arrangements will mirror the strategy and borrowing limits approved from time to time by the Financial Adviser's employing borough, i.e. Camden. The London Borough of Camden has adopted the 'CIPFA Code of Practice for Treasury Management in the Public Services'.

7. Prudence

7.1 The prudential indicators in respect of external debt constitute operating limits and therefore they must be set and revised taking into account affordability. It is by this means that the Code's objectives of sustainability and prudence are addressed each year.

7.2 Quite apart from the setting of indicators however it is important that day-to-day Treasury management is carried out in accordance with good professional practice if the prudent objective is to be met.

8. Decision Making on Capital Investment

8.1 The Code aims to ensure that capital investment is undertaken only after a proper decision making process. A soundly formulated capital programme must be driven by the desire to provide high quality, value for money public services. The Code recognises that in making investment decisions local authorities must have explicit regard to option appraisal, asset management planning, strategic planning for the Authority, and achievability of the forward financial plan.

8.2 The Code does not specify how a local authority should deal with these factors in detail. Rather it concentrates on the means by which the authority will demonstrate that its proposals are affordable, prudent and sustainable i.e. by use of the prudential indicators.

9. The Prudential Indicators

9.1 The majority of the indicators use information contained within the published Statement of Accounts. The indicators specified in the Prudential Code are the minimum required and individual local authorities could add more for their own use if they wished.

9.2 The specified indicators, which are concerned with demonstrating affordability and prudent treasury management, are as follows:-

Affordability

When local authorities are looking ahead for a three-year period:

- Estimates of the ratio of financing costs to net revenue stream
- Estimates of the incremental impact of capital investment decisions on the Levy
- Estimates of capital expenditure
- Estimates of capital financing requirement (underlying need to borrow for a capital purpose)
- Authorised limit for external debt
- Operational boundary for external debt

After the year-end the Authority will be required to review:

- Actual ratio of financing costs to net revenue stream
- Actual capital expenditure
- Actual capital financing requirement
- Actual external debt

Prudent Treasury Management

- Compliance with the CIPFA *Code of Practice for Treasury Management in the Public Services*
- Upper limits on fixed interest rate and variable interest rate exposures
- Upper and lower limits for the maturity, structure of borrowings
- Upper limit for principal sums invested for periods longer than 364 days

(The Authority uses the London Borough of Camden for treasury management who approve their management strategy on an annual basis and have adopted the CIPFA Code of Practice for Treasury Management in the Public Services).

9.3 The various prudential indicators must be reported to Members as part of the information for the setting of the levy. There are no levels at which the various indicators become good or bad. Nor are their league tables of indicators that should be used to judge (inappropriately) comparative performance. Rather the system relies on a rounded judgement with particular regard to likely levy effects.

10. **Assessment**

10.1 The new prudential system brings new choices to local authorities, e.g. they could choose to divert revenue resources to financing borrowing for capital purposes. Projects that produce real revenue savings will be easier to undertake and will not consume a centrally rationed borrowing approval. However, the system requires that whatever level of investment is chosen it must be subject to proper consideration and decisions locally about affordability, sustainability and prudence. Some key elements of the new prudential system will continue to be determined by legislation e.g. the method of government support for capital investment.

10.2 The CIPFA Prudential Code supports the new system of capital investment in local authorities and is now to be integrated within the wider statutory and management processes of local government. There is a presumption that authorities will comply with the Code.

11. **Financial Standing Orders**

11.1 Financial Standing Order D6 deals with the preparation of the Authority's capital programme. It is recommended that Financial Standing Order 6 (a) is updated as follows:

Current:

The Financial Adviser will make recommendations to the Authority regarding the capital programme. The report from the Financial Adviser will consider the capital resources available to the Authority, the revenue implications of the proposed expenditure, and any other relevant information.

Proposed:

The Authority will, on consideration of reports from the Financial Adviser, which will be at least annual to coincide with the setting of the Revenue Budget, make decisions in respect of the capital programme. The reports from the Financial Adviser will consider the capital resources available to the Authority in the context of the CIPFA Prudential Code for Capital Finance in Local Authorities, and any other relevant information. The Authority will, on the advice of the Financial Adviser, set and monitor the Authority's Prudential Indicators.

In addition the glossary should be updated to include the following:

Prudential Code

The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent, sustainable, and in accordance with good professional practice – or, in exceptional cases, to demonstrate that there is a danger of not ensuring this, so that the Authority can take timely remedial action.

11.2 The Local Government Act 2003 also places new duties on the Financial Adviser in respect of the Authority's revenue budget; this is considered as part of the report on the 2004/05 Revenue Budget and Levy. As a consequence, the full text of the proposed revised Financial Standing Orders can be found at Appendix A to that report.

12. Proposed Prudential Indicators for 2004/05 to 2006/07

12.1 The Authority incurred no capital expenditure in 2002/03. Although the Authority does not have any capital expenditure proposals for the period 2004/05 to 2006/07 (this may need to be reviewed in the light of the Joint Waste Strategy) it will need to account for the Ashburton Grove/ Hornsey Street replacement facility. Although the Ashburton Grove/Hornsey Street replacement facility will be provided to the Authority in the form of two 999-year leases, one at a peppercorn rent and the other at £100 per annum, the transaction counts as a credit arrangement (Section 7 of the Local Government Act 2003). Officers are currently in discussion with the external auditor to agree the value that should appear in the Authority's accounts. However, at the time of writing this has yet to be agreed and therefore it is proposed to err on the side of caution and to allow for a figure of £12.440m. The following capital expenditure estimates are recommended for approval:-.

Capital Expenditure					
	2002/03 Actual	**2003/04 Estimate**	**2004/05 Estimate**	**2005/06 Estimate**	**2006/07 Estimate**
NLWA	Nil	Nil	£12.440m	Nil	Nil

12.2 The Authority has no outstanding debt. Also, the Authority currently has no new plans that will involve external borrowing. As a consequence, the following ratio of financing costs to net revenue stream are recommended for approval:-

Ratio of Financing Costs to Net Revenue Stream					
	2002/03 Actual	**2003/04 Estimate**	**2004/05 Estimate**	**2005/06 Estimate**	**2006/07 Estimate**
NLWA	Nil	Nil	Nil	Nil	Nil

12.3 The Capital Financing Requirement measures the underlying need to borrow and will therefore include the Ashburton Grove/Hornsey Street transaction. The following capital financing requirements are recommended for approval:-

Capital Financing Requirement					
	31.03.03 Actual	**31.03.04 Estimate**	**31.03.05 Estimate**	**31.03.06 Estimate**	**31.03.07 Estimate**
NLWA	Nil	Nil	£12.428m	£12.416m	£12.404m

12.4 In order to ensure that over the medium term borrowing will only be for a capital purpose, the Authority, will need to ensure that net external borrowing does not, except in the short term, exceed the total of the Capital Financing requirement in the previous year plus estimates of any additional Capital Financing Requirement for the budget year and the next two years. Given the current uncertainty about the value to be included in the Authority's accounts for the Ashburton Grove/Hornsey Street transaction, the following authorised limits for external debt are recommended for approval:-

Authorised Limit for External Debt					
	2002/03 Actual	**2003/04 Estimate**	**2004/05 Estimate**	**2005/06 Estimate**	**2006/07 Estimate**
Borrowing	Nil	Nil	Nil	Nil	Nil
Other long term liabilities	Nil	Nil	£14m	£14m	£14m

12.5 The following operational boundaries for external debt are recommended for approval-

Operating Boundary for External Debt					
	2002/03 Actual	**2003/04 Estimate**	**2004/05 Estimate**	**2005/06 Estimate**	**2006/07 Estimate**
Borrowing	Nil	Nil	Nil	Nil	Nil
Other long term liabilities	Nil	Nil	£14m	£14m	£14m

12.5 The above indicators may need to be reviewed in the light of the Joint Waste Strategy which is due to be finalised during 2004/05.

13. Conclusion

13.1 This report outlines the requirements of the new prudential code for borrowing and asks the Authority to approve changes to its Financial Standing Orders and to approve the Authority's prudential indicators for 2004/05 to 2006/07. The report also indicates that the prudential indicators may need to be reviewed in the light of the proposed Joint Waste Strategy which is due to be submitted to the London Mayor for approval in September.

14. Comments of the Legal Adviser

14.1 The Legal Adviser has been consulted on this report and has no further comments to make.

Local Government Act 1972 - Section 100 as amended

Documents used in the preparation of this report:-

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI No 3146)

CIPFA – The Prudential Code

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