Prudential Indicators and Treasury Management Strategy

Proposed prudential indicators for 2014/15– 2016/17

1. Introduction

1.1 Police and Crime Commissioners are required by regulation to have regard to the Prudential Code when carrying out their duties. The objectives of the Code are to ensure that the capital investment plans of the Commissioner are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate the fulfilment of these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The indicators should be considered in parallel with the treasury management indicators required by the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The prudential indicators and treasury management strategy for the current year have been reviewed and no changes are considered necessary to the strategy.

2. Capital Expenditure

2.1 The following table provides details of the actual capital expenditure for 2012/13 and estimates for the current year (2013/14) and future years. The estimates for 2014/15 to 2016/17 are based on the budget for those years included in the current Medium Term Financial Strategy.

	2012/13 £000's	2013/14 £000's	2014/15 £000's	2015/16 £000's	2016/17 £000's
ANNUAL SCHEMES					
Vehicles	977	1,657	1,840	1,670	1,860
IT Equipment	397	295	600	600	600
Buildings					
NEW SCHEMES					
Mobile Data	511	51	150		
Intelligence System	103				
CJ Digital Systems	11				
IAM			166		
New Joint Firearms facility	209	0	77		
CMD Telephony	540	635	57		
Bearlands & Lansdown Contingency	945	135	150		
VDI	0	0	1,404		
Radio Replacement	711				
EDL		0	240		
Design Costs		150	150		
IT Replacement			300		
Vehicle Replacement			500		
New Custody Project	284	8,043	3,932	168	
Eastern Avenue Site	997	203			
Estates Strategy					
TOTAL CAPITAL EXPENDITURE	**5,685**	**11,169**	**9,566**	**2,438**	**2,460**

Additional expenditure has been approved since the budget was agreed.

2.2 The net revenue stream for the financial year is the amount to be met from government grants and local taxpayers. An indicator is required for the cost of financing the capital programme by calculating the ratio of financing costs to net revenue stream. The actual for 2012/13 and the estimates for the current and future years arising from the programme are:

2012/13 Actual	2013/14 Budget	2014/15 Budget	2015/16 Budget	2016/17 Budget
0.4%	**0.5%**	**0.5%**	**0.5%**	**0.5%**

3. Capital Financing Requirement

3.1 This indicator is calculated in the light of a key rule relating to capital finance – *that all expenditure of a local authority should be charged against revenue in the year it was incurred unless statute allows otherwise*. The capitalisation of costs is one of those exceptions.

3.2 In order to arrive at the capital financing requirement the following is deducted from capital expenditure:

- The application of grants and contributions
- The application of capital receipts
- The statutory charge to revenue (Section 4)
- Any voluntary additional charge to revenue (including transfers from the capital reserve)

3.3 Therefore the capital financing requirement may be defined as:

- The underlying need to borrow for a capital purpose, or,
- The effect of the capital programme yet to be charged to revenue

3.4 The actual capital financing requirement as at 31 March 2013 and the estimates for the current and future years arising from the programme are:

2012/13 Actual £000	2013/14 Budget £000	2014/15 Budget £000	2015/16 Budget £000	2016/17 Budget £000
8,598	8,227	7,872	7,530	7,202

3.5 In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Commissioner should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years

3.6 There was no difficulty in meeting this requirement in 2012/13, nor are there any difficulties envisaged for the current or future years, due to the level of reserves.

4. Minimum Revenue Provision (MRP)

4.1 The process for charging capital expenditure to revenue is a statutory requirement, and is called the minimum revenue provision (MRP). The regulations regarding MRP have been amended with effect from 31st March 2008, and there is now a simple duty to make an amount of MRP that the authority considers to be “prudent”.

4.2 An annual statement of the policy on making MRP has to be approved by the Commissioner.

4.3 It is recommended that the following policy is adopted for MRP:

4.3.1 Supported borrowing on capital expenditure incurred prior to 1st April 2008 will continue to use the formulae in the previous regulations (Regulatory Method)

4.3.2 Borrowing on all other capital expenditure will use the Asset Life Method. Provision for MRP is made over the estimated life of the asset for which the borrowing is undertaken, using the equal instalment method.

5. External Debt

5.1 In respect of external debt Commissioners are required to set an Authorised Limit and an Operational Boundary. The following limits are proposed:

	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000
Authorised Limit	9,850	9,850	9,850	9,850
Operational Boundary	8,850	8,850	8,850	8,850

5.2 The two limits are based upon the same prudent estimate which, for example, allows for shortfalls against the estimated level of capital receipts or specific funding.

5.3 In addition the Authorised Limit allows sufficient headroom to allow for operational requirements such as unusual cash movements.

5.4 An indicator is required to demonstrate the incremental effect of new capital investment decisions on the Council Tax.

5.5 Paragraph 2.1 above gives details of the assumptions made in arriving at the estimates of capital payments. Currently additional provision within the medium term programme has only been assumed where specific finance is anticipated.

5.6 At this stage therefore, for the purpose of calculating the indicator, this provision is regarded as the ‘new capital investment decisions’.

5.7 The additional borrowing requirement assumed in line with the above is:

2014/15	2015/16	2016/17
NIL	NIL	NIL

5.8 The estimates of the incremental impact of the new capital investment decisions on the Council Tax are:

	2014/15	2015/16	2016/17
For the Band D Council Tax	£0.00	£0.00	£0.00
Cumulative increase	£0.00	£0.00	£0.00

6. Borrowing and temporary investments strategy for 2014/15

Treasury Management

6.1 The Commissioner has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

6.2 The estimated total debt outstanding at 31st March 2015 is £8.850m. Our fixed rate investments are not expected to fall below £10m so our maximum net interest rate exposure is negative. It will not increase above zero in 2014/15, 2015/16 and 2016/17.

6.3 ***It is recommended*** that the Commissioner sets an upper limit on fixed interest rate exposure of £10m for 2014/15, 2015/16 and 2016/17. This allows up to 100% of borrowing to be taken at fixed rates.

6.4 ***It is*** further ***recommended*** that the Commissioner sets an upper limit on variable interest rate exposure of £2.5m for 2014/15, 2015/16 and 2016/17. This allows about 25% of borrowing to be taken at variable rates, even if all investments were at fixed rates.

6.5 ***It is recommended*** that the Commissioner sets upper and lower limits for the maturity structure of borrowings as follows.

The amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate:

	Upper limit	Lower limit
Under 12 months	40%	0%
12 months and within 2 years	20%	0%
2 years and within 5 years	35%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	25%

6.6 ***It is recommended*** that the Commissioner sets an upper limit for principal sums invested for periods longer than 364 days, for 2014/15, 2015/16 and 2016/17 of zero.

Borrowing Strategy 2014/15

6.7 Capital borrowing consists of £8.850m of fixed interest rate loans.

6.8 Borrowing at variable rate is generally avoided, but would be worth considering as a short-term measure if these rates were lower than longer-term fixed rates. Such borrowing would be converted to a fixed rate loan at a later date, as short-term rates rise. For budget purposes it has been assumed that the average borrowing rates during the MTFS will be 4.52%.

6.9 Although borrowing purely to invest at a profit is unlawful, borrowing in advance of expenditure to be incurred in the reasonably near future is acceptable. However, our policy is to borrow close to the year end, when the borrowing requirement for that year is known, so there is currently no borrowing in anticipation of future need. However, should there be a strong expectation of long-term borrowing rates rising during a year, consideration would be given to taking out the necessary borrowing for that year, before incurring the expenditure. Borrowing for expenditure in a future year will not be undertaken.

6.10 Temporary Investments Strategy

The Commissioner has a working balance and other reserves that are available for temporary investment. Investments are managed in-house, with lending being mainly to banks, building societies and money market funds. This lending is typically for short periods, with loans out at any one time usually ranging from overnight to four months. In the current financial climate few investments will be made for more than six months. For budget purposes it has been assumed that average investment returns for 2014/15 will be 1.0%, and will continue at this rate for 2015/16 and 2016/17.

6.11 DCLG Guidance

The Secretary of State has issued guidance on prudent investment practice under section 15 (1) (a) of the Local Government Act 2003. In addition to complying with the Prudential Code there is a requirement to have regard to this guidance.

6.12 The guidance is based on the priority for investments being security and liquidity, rather than yield. This is consistent with our treasury management policy.

6.13 Specified investments are defined in the guidance as those offering relatively high security and high liquidity and must be in sterling with a maturity of no more than a year. Investments made with the UK Government or a UK local authority automatically count as specified investments. In addition, investments with organisations that have "high credit quality" will count as specified investments, but it is for the Commissioner to determine, as part of the annual investment strategy, the definition of this term.

6.14 ***It is recommended*** that "high credit quality" is defined as a credit rating of AA for banks and building societies and as AAA for money market funds. There is currently a limit of £10m for money market funds. At the present time no investments are made with foreign banks and there are two money market funds on the approved lending list. Credit ratings are constantly monitored by our treasury management advisors. Further investments would cease immediately upon any warning of an actual or possible downgrading below the defined levels.

6.15 A non-specified investment carries a greater potential risk and the annual investment strategy must identify the general types of investment that may be used during the course of a year and must set a limit on the overall amount that may be held in such investments.

6.16 The current approved lending list includes all UK banks and building societies with assets in excess of £1 billion and many of these do not have a credit rating (the list includes Santander and Clydesdale which are registered in the UK but have foreign owners). In addition, the list includes wholly owned subsidiaries of UK clearing banks. ***It is recommended*** that these are approved as non-specified investments. The current limits for investment are as follows:

- Building Societies – overall limit of £30m and limit of £6m per institution
- Banks – overall limit of £35m and limit of £8m per institution
- Wholly owned subsidiaries of clearing banks – overall limit of £10m and £5m limit per institution.
- Our treasury management advisors would provide warnings about any risks involved in placing deposits with these institutions and no further investments would be placed until such time as the risk disappeared.

6.17 The strategy must also specify the principles for determining the amount of funds that can be committed for more than a year. The Commissioner currently maintains only cash flow investments that are not considered appropriate for longer-term investment. All these investment balances will therefore be maintained as short-term investments.

6.18 Arlingclose Limited (formerly Sterling International Brokers Ltd) are used as private-sector treasury management consultants; they are employed by a number of public bodies and should provide early warning of any risks associated with dealing with any of the institutions on our approved lending list. The quality of their advice is monitored by the treasury management staff to ensure the service meets our needs.

6.19 Training for treasury management staff is undertaken by in-house staff providing on-the-job training and by external consultants where necessary, to ensure that staff are kept up-to-date with treasury management issues.

6.20 The Treasurer has delegated authority to determine the arrangements for treasury management in accordance with the Treasury Policy Statement and annual strategy.