

**COMMITTEE:** GRAMPIAN JOINT POLICE BOARD

**DATE:** 20 JANUARY 2012

**TITLE OF REPORT:** PRUDENTIAL INDICATORS AND REVIEW OF  
TREASURY MANAGEMENT GOVERNANCE  
ARRANGEMENTS

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**1. PURPOSE OF REPORT**

To present to the Board for its consideration details pertaining to the Local Government Investment (Scotland) Regulations 2010 as they apply to the Force and the Prudential Indicators that relate to the Capital Plan.

**2. RECOMMENDATION(S)**

The Board is requested to note the contents of the Report and approve the Prudential Indicators.

**3. FINANCIAL IMPLICATIONS**

The detailed financial implications are set out in within Section 6 of this Report. However, the key point is that the Force's investment in capital assets must be affordable, sustainable and prudent. The main test of affordability will be whether any capital financing costs can be contained within the Force's revenue budget. The Force also needs to ensure that the financial assets/liabilities are managed within existing statutory and professional frameworks.

**4. SERVICE & COMMUNITY IMPACT**

It is important that the Force continues to invest in its infrastructure, assets and systems in order that it can enhance the operational capacity and generate efficiencies for front line policing.

**5. OTHER IMPLICATIONS**

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## 6. REPORT

- 6.1 The Force is required to follow the Local Government Investment (Scotland) Regulations 2010, which relate specifically to Section 40 of the Local Government in Scotland Act 2003. This statutory power allows local authorities and similar public bodies to undertake investments so long as they adhere to prescribed conditions. With the introduction of the Regulations in 2010, these public bodies have been afforded a greater level of autonomy in their investment activities.
- 6.2 However, with this greater freedom comes the responsibility to act prudently with regard to investment and treasury management activities. Investments need to be managed in order to minimise the risk to the capital sum and optimise the return on the funds, consistent with those risks.
- 6.3 The Scottish Government has identified two CIPFA Codes of Practice, which public bodies are required to follow in order to manage their investments in accordance with the Regulations. The publications are; Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, and The Prudential Code for Capital Finance in Local Authorities.
- 6.4 The Code of Practice covers all matters relating to Treasury Management including the fundamental principles for making and managing investments. Aberdeen City Council manage the Force's cash balances as part of a shared service arrangement. The management of investments requires specialist knowledge and systems, thus it is appropriate to utilise the services of the Council given that they have sufficient experience in this area and operate efficiently. As the Force has delegated responsibilities for Treasury Management to the Council, it is therefore reliant upon the Council to follow such guidance and regulations.
- 6.5 The Prudential Code was introduced in conjunction with the Local Government (Scotland) Act 2003 and provides a framework for the control of capital investments. The Force is required by regulation to comply with the Prudential Code when carrying out its duties under Part 7 of the Local Government in Scotland Act 2003 (Part 7 of the Act confers a duty on the Joint Police Board "to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure").
- 6.6 The objective of the Prudential Code is to provide a framework for capital finance which will ensure that:
- capital investment plans are affordable,
  - all external borrowing and long term liabilities are within prudent and sustainable levels,
  - treasury management decisions are taken in accordance with good professional practice,

and in taking decisions as set out above, the Joint Police Board is:

- accountable by providing a clear and transparent framework.

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Furthermore, the framework for considering investment plans supports:

- local strategic planning,
- local asset management planning, and
- proper option appraisal.

6.7 The framework includes a set of prudential indicators that need to be considered together rather than individually. It integrates three key components, namely, capital expenditure plans, external debt and treasury management processes. This should allow for good financial management as the indicators are designed to support and record local decision making. The indicators will be unique to the Force and should not necessarily be used as a means of comparison with other public bodies. Circumstances may exist where one investment plan differs markedly from another in both nature and scale.

### **Treasury Management Governance Arrangements**

6.8 Under the current arrangement (a shared services agreement), the principles set down within the aforementioned Local Government Investments (Scotland) Regulations 2010, will be adhered to by the Treasury Function within Aberdeen City Council.

6.9 A copy of the Treasury Management Policy and Strategy Report that was submitted to the Finance and Resources Committee of Aberdeen City Council in April 2011, is attached at Appendix A for information. This sets out the Council's Treasury Management Policy Statement and the Investment Strategy for the 3 year period 2011-14, thus demonstrating compliance with the Regulations.

### **Prudential Indicators**

6.10 The Prudential Code requires the Force to review five key areas, namely, Affordability, Prudence, Capital Expenditure, External Debt and Treasury Management. These incorporate a range of specific Prudential Indicators, which are set out below and are based upon the best information available.

### **Prudential Indicators for Affordability**

6.11 The aim is to ensure that the Force's investment in capital assets over the next three financial years is affordable and within sustainable limits. At the start of the current financial year (2011-12) the Force had £8.124m of long term debt. This originated from the capital expenditure incurred during the late 1980's and early 1990's.

6.12 The interest and loan repayments for this long term debt are supported in full by the Scottish Government, although 49% of the annual funding is routed through the Constituent Authorities and included within the annual requisitions.

- 6.13 Prudential Borrowing normally refers to the situation where the Force starts to borrow in order to part fund the proposed spend within the Capital Plan. It is important that the resultant revenue costs associated with interest charges and loan repayments are not prohibitive as this may adversely affect the Force's financial stability. The repayment of debt associated with Prudential Borrowing has to be found from existing revenue budgets and therefore consideration needs to be given to the affordability of such costs year on year.
- 6.14 The following indicators reflect the extent to which the underlying need to borrow impacts upon the Force's finances:

**Prudential Indicator 1** - Actual and estimated ratio of capital financing costs to net revenue stream.

<b>Actual/Estimated Ratio of Capital Financing Costs to Net Revenue Stream</b>				
Actual 2010-11 %	Estimate 2011-12 %	Estimate 2012-13 %	Estimate 2013-14 %	Estimate 2014-15 %
1.40	1.40	1.40	1.20	1.04

- 6.15 This indicator is intended to measure the percentage of the Force's revenue funding that will be committed to meeting the costs of the borrowing used to fund capital expenditure.
- 6.16 The relative percentage is reducing over the five year period as some of the long term loan debt matures and is repaid. This historic long term debt is also fully funded. There is no requirement as yet for the Force to undertake any form of Prudential Borrowing.

**Prudential Indicator 2** - Estimated incremental impact of capital investment decisions on the revenue budget.

<b>Estimates of the Incremental Impact of Capital Investment Decisions on the Revenue Budget</b>			
Estimate 2011-12 £000	Estimate 2012-13 £000	Estimate 2013-14 £000	Estimate 2014-15 £000
600	400	500	(1,700)

- 6.17 This indicator is intended to measure the incremental impact of capital investment decisions on the Force's revenue budget for the current financial year (2011-12) and the subsequent three financial years. The increases reflect the requirement to fund an element of the Capital Plan (in particular the new Custody Facilities in Aberdeen), from the revenue budget and from the Force's revenue reserves.

### **Prudential Indicators for Prudence**

- 6.18 Whilst the issue of affordability is addressed by the indicators noted above, it is important that external debt is kept within sustainable and prudent limits year on year. Net borrowing over the medium and long term should only be used for capital purposes, consequently the Force should ensure that net external borrowing does not (except in the short term) exceed the total of the capital financing requirement.

- 6.19 However, as the Force does not operate a loans fund and the portfolio of long term debt includes only 15 individual loans with maturity dates extending from 2011 to 2056, it is more appropriate to compare the capital financing requirement with the notional loan debt balances at the end of each financial year. The Force has a significant net current assets' balance, which will be used to pay the loans on their respective maturity dates. Monies set aside for the repayment of these loans, are accruing within the short term investment balances year on year.

**Prudential Indicator 3 - Net borrowing and the capital financing requirement.**

<b>Estimated Net External Borrowing and the Capital Financing Requirement</b>				
	Estimate 31/03/12 £000	Estimate 31/03/13 £000	Estimate 31/03/14 £000	Estimate 31/03/15 £000
Estimated Net Borrowing	5,185	4,560	4,123	3,779
Estimated Capital Financing Requirement	6,629	6,004	5,567	5,223

- 6.20 The net borrowing totals equate to the balance of notional loan debt at the end of each financial year. There is a difference between the notional loan debt and the actual loan debt, and this is detailed in Prudential Indicator Number 6. The Force's estimated capital financing requirement exceeds its estimated notional borrowing position year on year and demonstrates a prudent capital investment strategy.

**Prudential Indicators for Capital Expenditure**

- 6.21 The Board is required to make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and the following two financial years.
- 6.22 The capital expenditure for the financial years as indicated are based on the agreed Capital Plan for the current financial year and the subsequent three financial years. Experience from previous years indicates that changes to planned capital expenditure programmes can become necessary during the year and the new flexibility provided by the Prudential Code may bring about unforeseen opportunities during the year, which the Force could take advantage of.

**Prudential Indicator 4 - Actual/Estimated capital expenditure.**

<b>Actual/Estimated Capital Expenditure</b>					
	Actual 2010-11 £000	Estimate 2011-12 £000	Estimate 2012-13 £000	Estimate 2013-14 £000	Estimate 2014-15 £000
Capital Expenditure	2,845	2,921	7,347	8,036	2,216
(Less) Receipts/ Contributions	(2,845)	(2,921)	(7,347)	(8,036)	(2,216)
Net Capital Expenditure	Nil	Nil	Nil	Nil	Nil

- 6.23 The Force will be able to fund capital expenditure directly from Capital Grant; useable capital receipts; a direct charge to revenue (CFCR - Capital Financed from Current Revenue) and contributions from other parties towards the cost of a project. Capital expenditure that is not able to be financed from one of these funding streams will increase the capital financing requirement. The calculation of the capital financing requirement is, therefore, intended to reflect the Force's underlying need to borrow for a capital purpose and may increase over time as it incurs capital expenditure, which is not funded immediately via one of the above methods.
- 6.24 The estimates will not commit the Force to particular methods of financing. The Treasurer, in consultation with the Force's Chief Finance Officer, will determine the means by which capital expenditure will be financed.

**Prudential Indicator 5** - The estimated capital financing requirement.

<b>Estimated Capital Financing Requirement</b>			
31/03/2012	31/03/2013	31/03/2014	31/03/2015
£000	£000	£000	£000
6,629	6,004	5,567	5,223

- 6.25 After the year end the actual capital financing requirement will be calculated directly from the Force's balance sheet. The actual capital financing requirement exceeds the notional loan debt balance each year demonstrating that the long term loans are only being used to finance capital expenditure.

**Prudential Indicator 6** - The actual capital financing requirement.

<b>Actual Capital Financing Requirement</b>	
	31/03/11
	£000
Actual Capital Financing Requirement	7,254
Notional Outstanding Loan Debt	5,810
Actual Outstanding Loan Debt	8,124
Short Term Investments	16,770
Net Current Assets	7,201

**Prudential Indicators for External Debt**

- 6.26 The Board is required to consider three indicators relating to external debt, namely the authorised limit for external debt, the operational boundary for external debt and actual external debt for the latest completed financial year.

**Prudential Indicator 7** - Authorised Limit.

- 6.27 An authorised limit is required to be set for the Force's total external debt for the current and future financial years.
- 6.28 Based on the Force's approved Capital Plan, the authorised limit represents a maximum value which the Board's total external debt must not exceed. This indicator is intended as a backstop control mechanism over the Board's external debt position and is based on possible rather than probable events.

- 6.29 The estimates of what the Treasurer (in consultation with the Force's Chief Finance Officer) considers would be a reasonable authorised limit for the three financial years (2011-14) are included in the table shown below. The recommended limits are consistent with the Force's current commitments and existing plans / proposals within the revenue and capital budgets.

	2011-12 £000	2012-13 £000	2013-14 £000
Authorised Limit for External Debt	12,000	12,000	12,000

**Prudential Indicator 8 - Operational Boundary.**

- 6.30 This indicator focuses upon the day to day Treasury Management activity as employed by the Force. It is a means by which the Force will ensure that it remains within the self imposed authorised limit as indicated above. It differs from the authorised limit in that it is based on expectations of the maximum external debt of Grampian Police according to probable rather than possible events, and should be in line with the maximum level of external debt projected by the estimates. In this context total external debt needs to be expressed as gross of investments.
- 6.31 Unlike the authorised limit, an occasional breach of the operational boundary on a temporary basis should not be regarded as a significant problem but merely a situation which reflects the peaks and troughs nature of the Force's cash flow.
- 6.32 An operational boundary needs to be set for the current financial year and the following two financial years. This indicator is based on the Force's plans for capital expenditure (and financing) and an estimate of the most likely, but not worst case scenario on external debt.

	2011-12 £000	2012-13 £000	2013-14 £000
Operational Boundary for External Debt	10,000	10,000	10,000

**Prudential Indicator 9 - Actual External Debt.**

- 6.33 The Board is required to note what its actual external debt position was at the end of the latest completed financial year.
- 6.34 The Force's actual external debt as at 31 March 2011 was £8.124m.

**Prudential Indicators for Treasury Management**

- 6.35 Aberdeen City Council currently undertake the Treasury Management function on behalf of the Force. This includes the management of the Force's financial assets (including cash investments) and long term loans. The Council is authorised to act on the Board's behalf in financial dealings and does so through an agreed Service Level Agreement.

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6.36 Under the Prudential Code, the Board is required to adopt the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services. Under the current arrangement the Force relies upon Aberdeen City Council to adhere to the principles set down within the aforementioned Code of Practice.

6.37 There are specific prudential indicators relating to interest rate exposures, the maturity structure of borrowing and the total of sums invested for longer than 364 days. However, these indicators will be managed as part of the Treasury Function within Aberdeen City Council.

## 7. REPORT AUTHOR DETAILS

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