CIPFA The Chartered Institute of Public Finance & Accountancy

# Consultation on Proposed Changes to the Prudential Code

# Closes 30th September 2017

## INTRODUCTION

The first version of the Prudential Code for Capital Finance in Local Authorities, CIPFA, 2011 (Prudential Code) was published in 2003. The Prudential TM Code provides a framework for ensuring that capital investment is prudent, affordable and sustainable.

The Prudential Code was last updated in 2011. Since then the landscape for public service delivery has changed significantly following the sustained period of reduced public spending and the developing localism agenda. It was therefore considered an appropriate time for the Prudential Code to be reviewed and for views to be sought from stakeholders of areas where it can be strengthened or amended. The initial consultation was therefore launched on 22 February 2017 and closed on 21 April 2017.

## RESPONSES AND PROPOSED CHANGES

### Objectives

There were 63 consultation responses and all respondents, bar one, agreed that the four objectives were still relevant. The one exception suggested that Objective iii) should be deleted, but that the other objectives were still relevant. Objective iii) is that treasury management decisions are taken in accordance with good professional practice and a number of other respondents also queried whether the Prudential Code was the appropriate place for the "Adoption of the Treasury Management Code" prudential indicator, especially given that local authorities are statutorily required to "have regard" to both Codes.

It is therefore proposed that objective iii) be deleted and the requirement of the Prudential Code to adopt CIPFA's Treasury Management Code is removed.

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| Q1: Do you agree that the requirement of the Prudential Code to adopt CIPFA's Treasury Management Code is removed? |

### Mayors, Combined Authorities and the Group Entity

The consultation sought views on whether the code adequately covered mayors and combined authorities and there was broad support for specific references to mayors and combined authorities but with a recognition that given the diverse structure of these throughout local government some flexibility needed to be retained over the application of indicators.

On the question of whether the code should be expanded to include the group entity an initial analysis of responses suggested support was roughly split down the middle. Further analysis, however, showed a broad consensus as to the principle but concern over how this could be applied in practice.

It is proposed that the revised code confirm that the underlying principles apply to mayors and combined authorities and the group entity but that the use of local indicators is encouraged to recognise the differing impact of residual liabilities on the individual local authority.

In considering the impact of the code on mayors and combined authorities, it was recognised that limitations exist as to the streams of funding from which capital expenditure can be financed, examples may include a separate police fund, transport funding or financing that falls back on individual constituent authorities. It is therefore proposed that a requirement to consider the affordability of borrowing in respect of ring-fenced borrowing in addition to overall resources is introduced. This requirement can be met through the use of local indicators. Given that the HRA is effectively such a separate ring-fenced fund, the specific requirements in respect of the HRA have been removed as it is considered that the previous requirements will be met by the new requirement.

Q2: Do you agree that the Code confirm that the underlying principles apply to mayors and combined authorities and the group entity?

Q3: Do you agree that the impact of such structures is best dealt with through the use of local indicators?

Q4: Do you agree with the requirement to consider explicitly separate ring-fenced funding streams and that this requirement removes the need to specify separate requirements for the HRA?

**Ensuring Prudence**

The consultation raised a number of issues with prudence in respect of longer term planning, the minimum revenue provision, increasing commercialisation, understanding of risk and the ability to raise the council tax. It was recognised that the current three year period covered by the prudential indicators did not support longer-term decision making and financial strategies whilst accepting that it would be difficult to specify indicators over a longer timescale within the code.

Taking an overview of the individual consultation responses, it became clear that the use of indicators alone could not fill the perceived gaps and were in danger of promoting a 'tick-box' type approach when what was required was more contextual information around the impact of the longer term strategy risk on the financial sustainability of the authority.

It is proposed to introduce a requirement to report on the overall capital strategy to full council in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. The capital strategy should sets out the long term context in which capital expenditure and investment decisions are made and give due consideration to both risk and reward and impact on the achievement of priority outcomes. Where budget decisions are made by an elected mayor or a police and crime commissioner, it expected that the capital strategy and prudential indicators will follow the same procedures as the budget.

In order to encourage authorities to reflect local circumstances and priorities it is proposed that a principles based approach is taken, highlighting key areas to be covered. The proposed wording is contained within the Annex to this report. In developing the capital strategy authorities are encouraged to strike a balance between the amount of detail included and accessibility to the key audience. Links should be made where appropriate to the Treasury Management Strategy.

The capital strategy also allows borrowing for capital investment to be considered alongside more commercial type and third party investment so that the overall impact on affordability and risk on the financial sustainability of the authority can be identified and understood. This is particularly important as with increasing commercialisation it is vital that authorities identify all potential liabilities and risks and consider the combined impact on the overall financial position of the authority to ensure such activity remains proportionate.

In order to support an effective approach to risk management, and in line with the requirement for the Revenue Budget, it is proposed that the Chief Finance Officer should report explicitly on the deliverability, affordability and risk associated with the capital strategy. It is also proposed that the code recognises explicitly that the Chief Finance

Officer may need access to specialised advice to enable them to reach their conclusions.

It is proposed to remove the indicator relating to council tax impact to allow focus on a longer term and more informed view of affordability rather than relying upon a slightly contrived indicator.

Q5: Do you agree with the proposal to introduce the requirement for a capital strategy to be formally reported?

Q6: Do you agree with a principles based approach and that the key matters to be taken into account are reflected in the proposed wording within the annex?

Q7: Do you agree with the proposal to require the chief financial officer to report explicitly on the risks associated with the capital strategy?

Q8: Do you agree with the proposal to delete the council tax indicator?

**Other Proposed Changes**

As a result of the proposed changes some restructuring of the Code is required to remove duplication and improve readability.

It is proposed to remove the annexes relating to the calculation of the CFR and the HRA and instead ensure that these areas are covered in guidance. This will also allow more detailed guidance to be given in other areas where ring fenced funds exist and around Mayors and Combined Authorities.

The Executive Summary has been revised to reflect to the increased emphasis on long term financial sustainability within the code and improved decision making. The executive summary is reproduced in full in the annex and it should be noted that deletions and insertions relate only to the executive summary. All key new and deleted requirements are reflected in the extracts of the main code set out within the annex. As a result any additions in the executive summary not also contained within the extracts are not new requirements but merely a restatement of existing requirements.

**Responses and Next Steps**

CIPFA welcomes responses to all or part of the consultation, which should be made via email to matthew.allen@cipfa.org. The closing date for responses is 30th September 2017. Whilst respondents are encouraged as far as possible to meet this deadline to allow full consideration of responses, an extension may be requested via email.

It is intended to publish the revised code towards the end of the year for 2018/19 implementation.

**It is recognised that the introduction of the reporting requirement on the capital strategy may be a significant change for some authorities. This does however reflect existing best practice and authorities are encouraged to consider implementation ahead of the formal code requirements.**

**Annex**

**Revised Executive Summary In Its Entirety**

**Insertions are indicated by underlining, deletions by striking through.**

# Executive summary

## INTRODUCTION

**E1** The Prudential Code plays a key role in capital finance in local authorities. Local authorities determine their own programmes for capital investment ~~in fixed assets~~ that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA, the Chartered Institute of Public Finance and Accountancy, as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by Regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003, in Scotland under Part 7 of the Local Government in Scotland Act 2003 and in Northern Ireland under Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

## OBJECTIVES

**E2** The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management and investment decisions are taken in accordance with good professional practice and in full understanding of the risks involved. In exceptional cases the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action.

**E3** The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.

**E4** To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code does not include suggested indicative limits or ratios. These will be for the local authority to set itself, subject only to any controls under section 4 of the Local Government Act 2003 (England and Wales), section 36 of the Local Government in Scotland Act 2003 (Scotland) and section 14 of the Local Government Finance Act (Northern Ireland) 2011.

**E5** The prudential indicators required by the Prudential Code are designed to support and record local decision making in a manner that is publicly accountable. They are not designed to be comparative performance indicators. They 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*.

## SCOPE

**E6** The Prudential Code applies to all local authorities, including combined authorities, police, fire and other authorities.

## PROCESS AND GOVERNANCE ISSUES

**E7** The Prudential Code sets out a clear governance procedure for the setting and revising of a capital strategy and prudential indicators. This will be done by the same body that takes the decisions for the local authority's budget – ie usually it will be the full council for the authority concerned. The chief finance officer will be responsible for ensuring that all matters required to be taken into account are reported to the decision-making body for consideration, and for establishing procedures to monitor performance. Where budget decisions are made by an elected mayor or a police and crime commissioner, it expected that the capital strategy and prudential indicators will follow the same procedures as the budget.

**E8** Prudential indicators for previous years will be taken directly from information in local authorities' Statements of Accounts. If any item within a local authority's Statement of Accounts that is relied on for a prudential indicator is the subject of audit qualification, this must be highlighted when the prudential indicators are set or revised.

## MATTERS REQUIRED TO BE TAKEN INTO ACCOUNT

**E9** In setting or revising their prudential indicators, the local authority is required to have regard to the following matters:

service objectives, eg strategic planning for the authority

stewardship of assets, eg asset management planning

value for money, eg option appraisal

prudence and sustainability, eg risk, implications for external debt and whole life costing

affordability, eg implications for council tax/district rates

practicality, eg achievability of the forward plan.

**E10** The Local Government Act 2003 and the Local Government Finance Act (Northern Ireland) 2011 refer to affordability and the requirement that local authorities in England, Wales and Northern Ireland determine and keep under review the amount of money they can afford to borrow for capital investment. The Local Government in Scotland Act 2003 requires Scottish local authorities to keep under review the maximum amount they can afford to allocate to capital expenditure. In order to carry out their duties under legislation in respect of affordability, local authorities are required to have regard to all those aspects of the Prudential Code that relate to affordability, sustainability and prudence.

## DECISION MAKING ON CAPITAL INVESTMENT

**E11** A soundly formulated capital investment programme must be driven by the desire to provide high quality, value for money public services. The Prudential Code recognises that in making its capital investment decisions the authority must have explicit regard to option appraisal and risk, asset management planning, strategic planning for the authority and achievability of the forward plan.

## DETERMINING A CAPITAL AND INVESTMENT STRATEGY

**E12** In order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy that sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

~~The Prudential Code does not specify how the local authority should have regard to these factors. All of them represent elements of good practice for which guidance has already been provided by CIPFA and other authoritative sources. The Prudential Code instead concentrates on the means by which the authority will demonstrate that its proposals are affordable, prudent and sustainable.~~

## PRUDENCE

**E13** **The local authority shall ensure that all of its investments and borrowing are prudent and sustainable. In doing so it will take into account its arrangements for the repayment of debt (including through MRP/repayment of loans fund) and consideration of risk and the impact, and potential impact, on the authority's~~ies~~ overall fiscal sustainability. Whilst indicators for sustainability are required to be set over a minimum three year rolling period, indicators should be set in line with a capital strategy and asset management plan that is sustainable over the longer term.**

**E14** Local authorities are reminded that the prime policy objective of their treasury management investment activities is the security of funds, and they should ~~to~~ avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider a balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield. It is therefore important that authorities adopt an appropriate approach to risk management with regard to their investment activities.

~~By virtue of the requirements already listed above, the prudential indicators in respect of external debt must be set and revised taking into account their affordability. It is through this means that the objectives of sustainability and prudence are addressed year on year.~~

**E154** Both the authorised limit and the operational boundary for external debt need to be consistent with the authority's plans for capital expenditure and financing; and with its treasury management policy statement and practices. Risk analysis and risk management strategies should also be taken into account. The operational boundary should be based on the authority's estimate of most likely, ie prudent, but not worst-case scenario and should equate to the maximum level of external debt projected by this estimate. The authorised limit in addition needs to provide headroom over and above the operational boundary, sufficient for example for unusual cash movements.

**E16** In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that gross external debt 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. ~~This is a key indicator of prudence. Where there is a significant difference between the net and the gross debt position, the risks and benefits associated with this strategy should be clearly stated in the annual treasury management strategy.~~ Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds.

~~**E20** It is also prudent that treasury management is carried out in accordance with good professional practice. The Prudential Code requires local authorities to adopt the CIPFA *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*~~.

## AFFORDABILITY

**E17** The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the total capital investment of the authority remains within sustainable limits. In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it and those estimated to be available in the future, together with the totality of its capital plans and income and expenditure forecasts. ~~, and in particular to consider its impact on the local authority's 'bottom line' and hence council tax or district rates (Northern Ireland). Affordability is ultimately determined by a judgement about acceptable council tax or rates levels.~~

**E18** Consideration of affordability should be considered in the light of the authority's medium term forecast and other fiscal strategies. Capital expenditure plans should be considered alongside the cost of past borrowing maintenance requirements and planned disposals. The authorities MRP/Loan Funds policy will have a critical impact on the overall affordability of new borrowing and for this reason it is important to look at affordability not just in the medium term but also over the life of the asset base or underlying debt.

**E19** Where ring-fenced resources or separate funds such as the HRA or Police fund exist, affordability must be considered against those resources available to fund borrowing. Under combined authority arrangements affordability may need to be considered against combined authority resources and the impact on underlying authorities. Where debt or guarantees relating to LEPS, subsidiaries or other corporate and non-corporate bodies exist, the impact on the authority should be considered. In these cases the development of local indicators may be appropriate.

~~In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it/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. The authority is also required to consider known significant variations beyond this timeframe. This requires the development of three-year revenue forecasts as well as three-year capital expenditure plans. These are rolling scenarios, *not* fixed for three years.~~

**E20** When considering affordability, the authority needs to pay due regard to risk and uncertainty. Risk analysis and risk management strategies should be taken into account.

~~**E15** The following prudential indicators are key indicators of affordability:~~

~~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 council tax[1]~~

~~After the year end:~~

~~actual ratio of financing costs to net revenue stream.~~

## ~~THE PRUDENTIAL INDICATORS~~

~~**E21** The Prudential Code promotes transparency in decision making by using information contained within the published Statements of Accounts of the local authority and by having definitions for prudential indicators that are consistent with the definitions used within the Statements of Accounts.~~

~~**E22** The prudential indicators specified in the Prudential Code are the minimum required. Local authorities are encouraged to set further prudential indicators where this would assist their own management processes. However, any additional prudential indicators set locally should not, unless required to do so by legislation or official guidance, associate any part of the authority's external borrowing with particular items, categories or purposes of expenditure. The authority should have an integrated treasury management strategy within which its borrowing and investments are managed in accordance with best professional practice.~~

## CONCLUSION

**E21** The Prudential Code supports the system of capital investment in local authorities. It is integrated within the wider statutory and management processes of local government. Key elements of the system continue to be determined through legislation, in particular the amount required to be

~~[1] Or district rates, or precept, or levy, as appropriate.~~

charged to taxation by local authorities in respect of capital investment and the amount and method of government support for capital investment. These will be significant considerations when local government takes decisions on capital investment. However, the level of capital investment that can be supported will, subject to affordability and sustainability, be a matter for local decision.

**Extracts Showing Proposed Significant Changes to the Code including new paragraphs to be inserted and significant deletions.**

**Insertions are indicated by underlining, deletions by striking through.**

# Objectives

<u>The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.</u>

# Scope

<u>The prudential code covers all capital expenditure and investment decisions and should take account of all potential long term liabilities relevant to the authority. For authorities that are required to prepare group accounts or those involved in combined authority arrangements, the consideration of investments and liabilities should include all those which would be included in the group accounts.</u>

# Process and governance issues

## GOVERNANCE

**Decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority.**

The body that sets the budget for the local authority will usually be the full council of that local authority. Whether or not this is the case, the responsibility for decision making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with full council - ~~,~~ a~~A~~lthough detailed implementation and monitoring may be delegated to a committee ultimate responsibility lies with full council. In assessing how full council's responsibility is best delivered, authorities may wish to consider where the skills and knowledge to effectively implement and monitor detailed arrangements are placed within governance structures and how the active engagement of full council is best achieved.

Where budget decisions are made by an elected mayor or a police and crime commissioner, it is expected that the capital strategy and prudential indicators will follow the same procedures as the budget.

## DETERMINING A CAPITAL AND INVESTMENT STRATEGY

**In order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy that sets out the long term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes. The capital strategy should form a part of the authority's integrated revenue, capital and balance sheet planning.**

As local authorities become increasingly complex and diverse it is vital that those charged with governance understand the long term context in which investment decisions are made and all the financial risks to which the authority is exposed. With local authorities having increasingly wide powers around commercialisation, more being subject to group arrangements and the increase in combined authority arrangements, it is no longer sufficient to consider only the individual local authority but also the residual risks and liabilities to which it is subject.

The development of a capital strategy allows flexibility to engage with full council at the time the budget is set to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

**The capital strategy should be tailored to the authority's individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The capital strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.**

In considering how stewardship, value for money, prudence, sustainability and affordability can be demonstrated, the capital strategy as a minimum should cover:

Capital Expenditure

An overview of the governance process for approval and monitoring of capital expenditure, including links to the authority's policies on capitalisation.

A long term view of capital expenditure plans; where long term is defined by the financing strategy of, and risks faced by, the authority with reference to the life of projects/assets.

An overview of asset management planning including the opportunity cost of past borrowing, maintenance requirements and planned disposals.

Any restrictions around borrowing or funding of ongoing capital finance, for example requirements around the HRA or Police Funds.

Investments and Long Term Liabilities

The authority's approach to investments and commercial activities including processes, due diligence and defining the authorities risk appetite in respect of these including proportionality in respect of overall resources. While business cases may provide some of this material, these will often reflect historic rather than current circumstances so the information contained in them will need to be periodically re-evaluated when it will inform the authority's overall strategy.

An overview of the governance process for approval and monitoring of investments and financial guarantees including requirements for independent and expert advice and scrutiny arrangements.

Debt and borrowing

A projection of external debt and internal borrowing levels, including MRP/Loans Fund Repayments, over the life of the underlying debt.

Authorised and operating limits for the following year (see below).

Knowledge and Skills

A summary of the knowledge and skills available to the authority and confirmation that these are commensurate with the authority's investment risk appetite.

In developing the capital strategy a balance should be struck between the amount of detail included and accessibility to the key audience. Where detailed information is required thought should be given to how this is made available, its format, and the training needs of members to encourage active engagement. The role of the formal scrutiny process should not be overlooked in ensuring effective challenge. Links should be made where appropriate to the Treasury Management Strategy.

The Chief Finance Officer should report explicitly on the deliverability, affordability and risk associated with the capital strategy and where appropriate have access to specialised advice to enable them to reach their conclusions.

## SETTING AND REVISING PRUDENTIAL INDICATORS

The body that sets the budget for the local authority (the decision making body) will usually be the full council of that local authority. Whether or not this is the case, the setting ~~and revising of the prudential indicators~~ of the capital expenditure estimates, operational boundary and authorised limit should follow the same route as the setting and revising of the budget of the local authority. Other indicators may be delegated to committees or sub-committees of full council although full council retains overall responsibility. Where other indicators are delegated the impact of these should be taken into account when setting the capital expenditure estimates, operational boundary and authorised limit.

**Local Indicators**

Authorities should consider whether additional local indicators are needed to reflect local circumstances, including local indicators based on group accounts where relevant. Where appropriate, to improve understanding and relevance, these may be substituted for the relevant indicator set out within this code with the exception of the Authorised Limit and Operational Boundary.

# Prudence and prudential indicators for prudence

**The local authority shall ensure that all of its investments and borrowing decisions are prudent and sustainable. In doing so it will take into account its arrangements for the repayment of debt (including through MRP/Loans Fund Repayments) and consideration of risk and the impact, and potential impact, on the authorities overall fiscal sustainability. Whilst indicators for sustainability are required to be set over a minimum three year rolling period, indicators should be set in line with a capital strategy and asset management plan that is sustainable over the longer term.**

Local authorities are reminded that the prime policy objective of their treasury management investment activities is the security of funds, and they should ~~to~~ avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider a balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield.   It is therefore important that authorities adopt an appropriate approach to risk management with regard to their investment activities.

Prudential indicators include indicative figures for years two and three to allow decision to be made with an appreciation of future trends. It is recognised that these will be subject to change but exist to promote a move away from the focus on annual decision making towards longer term strategies. Three year figures are also required to evidence that borrowing is for capital purposes.

## ~~TREASURY MANAGEMENT~~

**The entirety of this section is deleted.**

# Affordability and prudential indicators for affordability

**The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits. ~~and in particular to consider its impact on the local authority's 'bottom line' and hence council tax or district rates (Northern Ireland). Affordability is ultimately determined by a judgement about acceptable council tax or district rates levels.~~**

Consideration of affordability should be considered in the light of the authority's medium term forecast and other fiscal strategies. Capital expenditure plans should be considered alongside the cost of past borrowing maintenance requirements and planned disposals. The authority'~~ie~~s MRP/Loans Fund Repayment policy will have a critical impact on the overall affordability of new borrowing and for this reason it is important to look at affordability not just in the medium term but also over the life of the asset base or underlying debt.

Where ring-fenced resources or separate funds such as the HRA or Police fund exist, affordability must be considered against those resources available to fund borrowing. Under combined authority arrangements affordability may need to be considered against combined authority resources and the impact on underlying authorities. Where debt or guarantees relating to LEPS, subsidiaries or other corporate and non-corporate bodies exist, the impact on the authority should be considered. In these cases the development of local indicators may be appropriate.

**The authority shall ensure that the revenue implications of capital finance, including financing costs, are properly taken into account within option appraisal processes, the capital programme and the medium term forecast. In assessing affordability the authority shall consider the council tax implications of its capital programme, borrowing and investment decisions.**

It is recognised that indicators of affordability are best determined in the light of local constraints around precepts and ring-fenced and statutory funds such as the HRA and Police Fund. Authorities are encouraged to use local indicators that reflect how capital finance is permitted to be financed locally. For example for those authorities with a HRA, the ratio of financing costs to revenue budget should be calculated within the HRA ring-fence and an impact on rents calculated. In setting indicators, it should be recognised however that ultimately all debts of a local authority fall on the taxpayer.

~~**Estimates of the incremental impact of capital investment decisions on the council tax**~~

~~**The local authority will forecast the total budgetary requirements for the authority arising from the proposed changes to the capital programme and calculate the addition or reduction to council tax[2] that would result.**~~

~~**This calculation shall be undertaken for the forthcoming year and the following two financial years or longer timeframe if required to capture the full-year effect of capital investment decisions. This prudential indicator will be referred to as estimates of the incremental impact of the new capital investment decisions on the council tax and shall be expressed in the following manner:**~~

~~**£xx.xx**~~

~~**NB Financial forecasts should be made on the basis of best information available at the time and making reasonable assumptions where there is a significant element of uncertainty.**~~

~~A fundamental indicator of affordability for the council to consider in setting its forward plans is the impact on the council tax that will result. This shows the actual impact of the capital investment decisions on the council tax. It allows the effect of the totality of the council's plans to be considered at budget-setting time. It also allows different options for the capital investment programme to be considered by comparing the different impact on council tax that would result, holding all other things constant other than varying the capital programme. Moreover, this indicator reflects the revenue impact of capital schemes other than financing costs, thus facilitating the consideration of revenue-intensive versus capital-intensive options.~~