

## **Luton Borough Council Model for Assessing Levels of Affordable Borrowing**

### **Prudent Borrowing for Luton Borough Council**

1. Borrowing cannot be considered in isolation from the rest of the Council's budget and council tax (or housing rent) strategy. Borrowing costs are an enduring 'first call' on Council funds and if borrowing is committed, the Council must be clear that it can and will allow for this within its overall budget and tax and rent- setting strategy.
2. Borrowing can only be considered if it is clear that the Council is prepared and able to set levels of council tax or housing rent that will ensure the borrowing costs can be paid both in the year of borrowing, and over the period of the medium term plan. It must also be reasonable to assume this will continue to be the case over the entire period of the loans.
3. This means that the budget risk management strategy must be considered, and in particular the Council must allow for:
  - reliance on potentially volatile sources of income, such as the airport;
  - known long-term liabilities – the pension fund deficit is a major issue;
  - areas of long-term continuing cost increases, such as waste disposal;
  - the potential for changes in the level of government support;
  - the total level of borrowing proposed in any year, and the level of risk involved both in terms of capital schemes and potential revenue impact;
  - overall borrowing levels, and the potential impact of interest rate variations;
  - For Housing Revenue Account (HRA) borrowing, the implications of the HRA business plan must be taken into account.
4. The Council is only allowed to use prudential borrowing to fund capital expenditure. There are 6 types of borrowing that may be considered.
  - a) Borrowing to fund a scheme that will reduce the Council's ongoing revenue costs in future years, or avoid increased costs in future years.
  - b) Borrowing to fund the purchase of essential vehicles plant and equipment in order to maintain Council functions.
  - c) Borrowing in advance of anticipated receipts to enable the Council to invest in capital expenditure before it has the income to fund the investment.
  - d) Borrowing to enable the Council to fund a larger capital programme than it is able to do using Government grant and supported borrowing.
  - e) Borrowing to fund an overspend on a large-scale capital scheme that would otherwise have to be funded from a revenue contribution to capital outlay, with major impact on the council's revenue budget.
  - f) Borrowing to cover the costs of a capitalisation request approved by government,
5. These types of borrowing need to be considered separately.
6. Borrowing to fund a scheme that will reduce the Council's ongoing revenue costs in future years, or avoid increased costs in future years, can be considered whether or not the Council has a balanced medium term plan, provided the business plan and costings are sufficiently robust to demonstrate the Council's ongoing revenue costs, net of the costs of borrowing, will reduce, and that the potential risks have been assessed and mitigated to the extent that successful project delivery is overwhelmingly probable. The scheme must be approved by the Head of Corporate Finance, and the business plan must demonstrate how the scheme will contribute towards the Council's aims and values. Any proposed scheme for investment in a service that is clearly not statutory will be further subject to Note A, below.

7. Borrowing to fund essential vehicles plant and equipment in order to maintain Council functions has become an important part of most councils' financial strategy, largely replacing operating leasing. This is because an asset can be written off over its useful life, without depending on residual value, and there are no hidden extra costs from secondary rentals, returning assets to leasing companies, or additional bills when the leasing company claims the returned asset is not in the condition it should be according to the contract.
8. Decisions on whether to lease or borrow need to be kept under review, and should leasing deals become more attractive than borrowing, they will need to be reconsidered.
9. Prudential borrowing is used to purchase essential vehicles, plant and equipment. In each case the accountable manager must demonstrate that the proposed replacement provides value for money.
10. Borrowing in advance of anticipated receipts to enable the Council to invest in capital expenditure before it has the income to fund the investment should only be considered when the Council can afford the cost of borrowing in its revenue budget, and it is clear that the Council could achieve that level of receipts relatively quickly. This method is used to fund core maintenance and housing renovation grants.
11. The Council may also wish to include specific expenditure in its capital programme that is dependent for resourcing on specific future receipts. Where this is done, expenditure should not be committed until the receipt is certain, both in terms of date and amount.
12. Borrowing to enable the council to fund a larger capital programme than it is able to do using Government grant and supported borrowing will be considered when the council is clear that it can set a balanced budget and medium term plan on a prudent basis, including the costs of the borrowing proposed.
13. Borrowing to fund a major overspend on a large-scale capital scheme will only be considered as a last resort. Firstly schemes will be managed to ensure that there should be no overspends, and the project managers will be accountable for achieving this. Secondly project managers will be accountable for seeking additional resources to cover any genuinely unavoidable overspend. Thirdly, if the project manager has been unable to manage the scheme within budget, and has been unsuccessful in achieving additional resources, the council will review the remainder of the capital programme to see what can be reduced or rephased to help cover the costs of the overspend. Should there still be a major financial shortfall, prudential borrowing can be considered subject to the Head of Corporate Finance being satisfied that otherwise the impact on revenue would be so great that prudential borrowing is the only effective alternative that can be recommended to Executive for approval.
14. Borrowing to cover the costs of a capitalisation request will be utilised where the council has had a capitalisation request approved by government to meet the one-off costs of a major reorganisation or claim brought against the council, and the Head of Corporate Finance recommends that the capitalisation direction should be applied.
15. Standard borrowing will normally be approved up to the level of 'supported borrowing' announced by government, subject to any unfunded costs (due to the impact of damping and floors on government support) being deemed affordable.
16. Capital Finance Amendment Regulations Minimum Revenue Provision Guidance is expected to be introduced in March 2008. On the assumption that the final version is broadly in line with the draft, the council will adopt the Regulatory method for

determining the minimum revenue provision for existing and new supported borrowing, and the asset life method for existing and new self-financed borrowing. The council will also reserve the right to use options available to take a 'minimum revenue provision holiday' in the construction phase of any new building or infrastructure that is self-financed. Should the final regulations be substantially different, the council will set its minimum revenue provision in line with regulation, aiming to spread the cost of principal repayments over the statutory period for supported borrowing, and over the expected asset life for self-financed borrowing.

17. Any proposals for borrowing for a Public Finance Initiative (PFI) scheme will require a separate detailed appraisal in accordance with CIPFA's recommendations for assessment of PFI, before it is considered.
18. When the Council is committed, as part of a balanced medium term financial plan, to funding capital schemes from the sale of revenue-producing assets, there will be an appraisal by the Head of Corporate Finance and the Head of Capital and Asset Management of the relative costs of borrowing and the loss of revenue. This will take into account future projections of growth in asset rentals based on provisions for rent reviews, etc. If the costs of borrowing are less than the loss of revenue, borrowing should be considered in place of asset sale.

#### Note A

If the Council's medium-term financial plan using cautious assumptions requires significant levels of saving to balance on an ongoing basis, then any schemes for investment in discretionary services require specific appraisal before they can be considered for borrowing.

This is because in such instances significant levels of saving are likely to have to be sought in discretionary services.

Any investment in a discretionary service is likely to commit the council to the provision of that service over an extended period. If so, and significant levels of saving are required, that investment will need to produce an appropriate proportion of such savings if it is to be supported by borrowing. Otherwise, in the longer-term, it may be better for the Council to reduce service levels.

#### Note B

The capital programme is based on assumptions concerning the use of receipts from the sale of council houses, revenue contributions (e.g. Airport) and third party contributions. Other funding routes may also be considered in future. These funding sources need to be considered separately, and borrowing should not be seen as a substitute for them. If there is a shortfall in another type of funding, the capital programme will need to be reduced in line with the shortfall.

Borrowing may however be used to forward fund over a three year period, provided that it is prudent and there is a real, risk-analysed expectation that the expected resources will materialise. If however, they should not materialise for any reason, the capital programme will have to be reduced in line with actual resource availability – borrowing cannot be increased in the long-term to cover the shortfall.

Any capital scheme that is earmarked to be funded from a specific source – e.g. third party contribution, public private partnership – will require a detailed business case, with an appraisal of its financial viability, and a risk assessment of the potential for cost variation, in terms of both capital costs, and potential ongoing revenue impact over the life of the project. This will need to feed in to the Council's medium term planning process, and so will affect the assessment of affordability of borrowing for supported capital schemes.