Resources Board

04 December 2017

Response to the Consultation on the Proposed Changes to the Prudential Framework of Capital Finance: Local Authorities Investment Code and Minimum Revenue Provision Guidance.

Purpose of report

For decision.

Summary

Following the recent consultations on the Cipfa Prudential Code for Capital Finance and the Treasury Management Code, DCLG are now consulting on associated aspects of the prudential capital framework. The proposed changes need to be understood in the context of the revised Cipfa codes and will impact on council investments and on provision needed to repay debt, which will impact on council revenue budgets. A suggested draft response from the LGA is appended for approval.

Recommendation

1. That the LGA's draft response to the Consultation on the Proposed Changes to the Prudential Framework of Capital Finance: Local Authorities Investment Code and Minimum Revenue Provision Guidance be approved for submission.

Action

2. To reflect the Board's comments in the repose and submit it to DCLG.

Contact officer: Bevis Ingram

Position: Senior Adviser (Finance)

Phone no: 0207 7664 3258

Email: bevis.ingram@local.gov.uk

Response to the Consultation on the Proposed Changes to the Prudential Framework of Capital Finance: Local Authorities Investment Code and Minimum Revenue Provision Guidance.

Background

1. DCLG has published a consultation on proposed changes to the statutory guidance on local authority investments and on Minimum Revenue Provision. These codes, together with the Cipfa Prudential code and the Cipfa Treasury management code, make up the prudential system for local authority capital finance. The Cipfa codes are currently being revised. This Board's meeting on 22 September approved the LGA's response to proposed revisions to those codes and the revised codes are expected to be published in December 2017. DCLG is now consulting on proposed revisions to the two codes that it maintains. The consultation closes on 22 December 2017.

2. As the Cipfa codes have not yet been published or finalised, it is not possible for local authorities to fully comment on the proposals in the consultation and changes to the Guidance on Local Government Investments and Statutory Guidance on Minimum Revenue Provisions. It is suggested that this point is made to the Government.

3. Nevertheless, a proposed response to the consultation is attached for the Board's comment and approval. The consultation has generated significant interest in the sector and in the trade press and this covering report outlines the main issues that have been highlighted in the proposed response.

Local Authority Investment Guidance

4. This guidance was last updated in 2010. Since then, the 2011 Localism Act has given local authorities wider powers. Some local authorities have used these powers to undertake wider commercial investments in order to generate income to replace lost central government funding. This particularly applies to investment in commercial property.

5. Many local authorities also make commercial investments in order to achieve wider social and economic benefits for their local areas such as by economic regeneration or by providing additional facilities for residents or visitors, and where they do so they are likely to rely on powers other than the 2011 Localism Act. Such investments will not be seen as being solely yield bearing investments. In this case, the application of the Local Authority Investment Guidance is not so clear and this raises issues of definition that are raised in the draft response.

6. However, where local authorities invest solely to make a financial return, whether that is in financial instruments or in commercial property, the investment is covered by this guidance.

7. The proposed changes to the guidance will potentially have major impacts on local authorities. Firstly, although this is not explicitly stated in the consultation, the accumulated impact of changes to the Cipfa prudential code and the statement in the consultation that "borrowing to invest is….considered to be borrowing in advance of need" could mean that in future local authorities will not be able to borrow in order to fund expenditure on investment property that is held solely to generate a return (currently such expenditure is not differentiated from other capital expenditure). This is highlighted in the introduction to the proposed response and is based on comments from a number of Chief finance officers of councils. If this is the case, this would be a significant change.

8. Currently investment in certain yield bearing opportunities (e.g. investment in property) is classified as capital expenditure and as such is eligible for funding from borrowing. Local authorities have invested in property in different ways for many years; if this is to be restricted it could have a major impact on their ability to fund and deliver services to their residents. Furthermore, if this change does go ahead and were to be applied retrospectively it would force councils to divest themselves of existing investments. The financial costs of this could be potentially disastrous for some councils. It is suggested that this point is reflected in the response.

9. Much of the consultation is about disclosure of information. The draft response makes it clear that we support full transparency in decision making, but that we highlight that some of the proposals do not help this. For example there is a proposal to ensure councils report on consistent indicators in investments to allow comparison between years and between local authorities. The proposals here are not clear, but in the draft response we make the point that trying to design a system to allow comparison between local authorities would not be practical and would not serve the purpose of investment indicators, and would impose a bureaucratic burden on councils. Consistent local comparison between years would appear to be a more sensible and proportionate approach.

10. These points are drawn out in the consultation response and members may wish to comment on these and on the other proposed responses to the specific questions

Minimum Revenue Provision Guidance

11. This is a technical area, but it has a big impact on councils' revenue finances.

12. Minimum Revenue Provision (MRP) is the annual amount that local authorities have to put aside as provision to repay debt, broadly to ensure that over time all capital expenditure not financed by grant or by capital receipts is financed from revenue. The guidance outlines the rules that councils have to follow in making that calculation. Overall there is a concern that the changes will make it more difficult to apply local conditions to the calculation.

13. The main concern with the proposals is that they could mean that councils have to make additional provision to repay debt, even where current provision is seen as prudent, and that this will therefore have a major impact on councils' revenue budgets affecting delivery of services.

14. The consultation is not clear on how some of the proposed changes will be implemented and whether they will be implemented retrospectively (though officials have indicated informally that this will not be the case, the point still needs to be confirmed formally). In any case the annual calculation will be based on the councils overall position, so there will inevitably be an element of retrospection which could cause problems for councils.

15. The consultation says that the changes will be implemented from 2018/19. This would be a significant problem in timing and would affect 2018/19 revenue budgets as well as immediate capital spending decisions which will be largely finalised before the consultation closes.

16. In addition, proposals to prevent councils from re-crediting previously overpaid MRP back to revenue could mean that costs are unbalanced between years.

17. These points are drawn out in the consultation response and members may wish to comment on these and on the other proposed responses to the specific questions.

Implications for Wales

18. The codes apply only to English local authorities. Nevertheless we have alerted the Welsh Local Government Association to the consultation.

Financial Implications

19. This is part of the LGA's core programme of work and as such has been budgeted for.

Next steps

20. To amend the draft consultation in the light of comments made by Resources Board members and submit the response to DCLG.