

## **CIPFA Consultations on the Prudential Code for Capital Finance in Local Authorities and on Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes**

### **Purpose of report**

For direction / clearance.

### **Summary**

CIPFA has published consultations on revised versions of the Prudential Code and the Treasury Management code. Proposed responses to each consultation are appended to this report for members comments and clearance. The consultation formally closes on 16 November however we have agreement from the CIPFA Chief Executive to send in the LGA's responses shortly after this date.

### **Recommendations**

That Members of the Resources Board approve the draft responses to the consultations appended to this report, subject to any amendments agreed at the meeting.

### **Action**

Officers will make any amendments to the draft responses and arrange submission to CIPFA.

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## **CIPFA Consultations on the Prudential Code for Capital Finance in Local Authorities and on Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes**

### **Background**

1. Members will recall that earlier this year CIPFA undertook a principles-based consultation on proposed revisions to the Prudential Code for Capital Finance in Local Authorities (the “Prudential Code”) and to the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (The “Treasury Management Code”). The LGA submitted responses to these consultations ([Prudential Code](#) and [Treasury Management Code](#)) following discussion at the April meeting of Resources Board and clearance from Lead Members. These current consultations are the second stage of this process.
2. The Prudential Code was introduced in 2004 and last revised in 2017 for application from April 2018. The code came about through the 2003 Local Government Act which enabled councils to set their own capital financing plans. Under section 3 of the 2003 Act each local authority was given a duty to “determine and keep under review how much money it can afford to borrow.” In order to do this, regulations (the capital finance regulations 2003) were laid by the Secretary of State that in order to discharge that duty local authorities “shall have regard to the code of practice entitled the “Prudential Code for Capital Finance in Local Authorities” published by CIPFA, as amended or reissued from time to time”. Similar regulations were laid by the Welsh Government to govern Welsh local authorities.
3. These changes were a major step in freeing local government from centrally imposed borrowing controls and the Government placing genuine trust and reliance in local government’s ability to manage its own affairs according to the sector’s own professional standards. The track record of local government since the Prudential Code was first introduced has shown both that local government has proved worthy of that trust and the code has an important place in enabling successful locally determined capital investment by local authorities.
4. The Treasury Management Code was introduced in 2001/02. Again, local authorities are required to “have regard” to the code in setting up and approving their treasury management arrangements. In practice the code is widely used, and it is likely that any local authority not following it would be required to justify (e.g. to its external auditors) why it had not used it.
5. The Prudential Code, and the Treasury Management Code form two parts of what is known as the Prudential Framework. In England, the other two parts are statutory guidance published by DLUHC - Guidance on Local Authority Investments (“[Investments Guidance](#)”) and the Guidance on Minimum Revenue Provision (“the [MRP Guidance](#)”). These were also last revised with effect from 1 April 2018. It is expected that DLUHC will consult shortly on proposed revisions to the regulations underpinning the MRP guidance as part of its [planned improvements to the local authority capital finance framework](#) published in July.

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6. The consultation ran for an eight-week period ending 16 November. We believe that eight weeks is too short a time for the sector as whole to respond to the consultation, particularly as it goes beyond what was proposed in the earlier consultation and included additional documents. We are grateful for an extension for the LGA's response but believe the consultation period should be twelve weeks as originally planned and it would be in line with the Government's good practice guide on consultations.
7. The actual questions in the consultation documents refer to specific paragraphs in the codes and changes made. Some of these changes relate to other proposals made in the first stage consultations; where this is the case, the proposed draft response reflects the points made in our response to the first stage. Otherwise, the response is largely in line with the points made below either as general points or in response to specific questions where these are relevant.

#### **General points on current consultation on Prudential Code**

8. In the earlier consultation, CIPFA stated that the proposed amendments sought to clarify the current meaning of the code rather than to make significant changes. This was particularly in relation to councils investing in commercial property. In our response we argued that the proposed amendments represented a clear change. We also argued that the proposed changes were out of proportion to the perceived problem that they sought to address, and that problem had already been addressed by regulatory and other changes elsewhere such as with the Government's statutory investment guidance in 2018 and new PWLB lending terms introduced in 2020. If agreed, the changes proposed would mean that the code is not aligned with the Government's investment guidance nor with the PWLB lending terms and guidance supporting them.
9. The current consultation also now appears to go well beyond the amendments proposed in the earlier consultation on principles and makes significant changes well beyond clarifying the current meaning of the code. If this is not CIPFA's intention, then the proposals are not clear. These changes could have a far-reaching impact on councils' stewardship of public money. The draft response argues that the changes that have been proposed are not clear and calls on CIPFA to reconsider. There is a danger that the proposals will cause significant confusion and other unintended consequences. It is essential that the guidance governing something as important as local authority borrowing and treasury management, which has direct implications for the delivery of local and national policy, is clear and enables councils to deliver on their fiduciary responsibilities to local communities.
10. It appears that local authorities that hold investments and also have outstanding debt are being encouraged to divest themselves of investments in order to pay down debt. The draft words say that this need not be done "immediately" (para 53 Prudential code). The draft response addresses this point by a suggested alteration of the words from "Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments" to "Authorities with existing commercial investments (including property) are not required by this Code to sell these investments".

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11. The draft codes and other documents published in the consultation when taken together appear to rule out local authorities investing in the property sector in any way for a financial return. Local authorities have a long history of investing in property for a variety of reasons, and the power to invest generally is enshrined in legislation. Investment in property enables local authorities to shape their localities, promote economic development and to enable economic regeneration. There is a concern that the changes proposed in the code will make this much harder to achieve.
12. This may affect pooled fund investments which have hitherto been regarded as prudent investments. The most obvious example is the Local Authority Property Fund managed by CCLA. This is specifically designed for local authority investors and is approved by HM Treasury. The Trustee for the fund is the Local Authorities' Mutual Investment Trust ("LAMIT") and is controlled by Members of the LAMIT Council, whose members and officers are appointed by the LGA, the Convention of Scottish Local Authorities, the Northern Ireland Local Government Officers Superannuation Committee, The Welsh Local Government Association, and also representative unitholders. The LGA therefore has a clear interest in this aspect of the proposals.
13. Although it is not entirely clear what is being proposed, it is possible to interpret the proposals here as meaning that local authorities should prioritise the security of the cash value of investments above all else, including instead of holding a strong and diverse investment portfolio and keeping pace with inflation. In this case there is a very strong likelihood that the real value of investments will decline significantly over time and that income that could have been achieved will be lost; we have heard views expressed that such an approach will guarantee real value losses over time. If this is the intention of the changes proposed, it does not seem to represent good stewardship of public funds.
14. Three documents were published with the consultation. These are called [Early Guidance on Investment Categories](#), [Early Guidance on why authorities should not borrow to invest](#), and [Local Authority Investment Classes Mapped to the Main Regulatory Requirements](#). It is not clear whether they are new documents or revised documents (or parts of bigger documents) and whether they form part of the consultation or if they have been included for some other purpose. It would have been helpful if CIPFA clarified the purpose of including these additional documents on the consultation web page. None of the actual consultation questions directly refer to these documents.
15. The consultation could have benefited from additional quality control before publication. A revised version of the consultation document was published after the initial publication, deleting questions that had been inserted in error. Even then the final published consultation document includes errors.

### **General points on current consultation on Treasury Management Code**

16. The earlier consultation concentrated primarily on proposals relating to skills and knowledge on Treasury management within local authorities. The current consultation follows up on this.

17. It is worth noting that section three of the code, which covers the code's status, and which has not been amended from earlier versions, includes the sentence "The Local Government Association has expressed strong support for the Treasury Management Code. It is encouraging the good practice set out in the Code". This endorsement has not been raised with us in the current consultation. Members may wish to discuss this endorsement, particularly with regard to comments made on proposed changes to the Prudential Code that will feed through into the Treasury Management Code, including changes to definitions of investments and how these will impact.
18. The clarity of the definitions in the Treasury Management Code itself could be improved. The opening statement is "The definition of treasury management includes all the investments of the organisation. This may include investment activity which is outside the purposes of normal treasury management". This appears to suggest that "treasury management" and "normal treasury management" may be different things, which is confusing. It is also not clear how the revised definitions in the Treasury Management Code interrelate with the additional documents published alongside the Prudential Code
19. We have also heard concerns expressed that including treasury management within a definition of commercial investments will restrict councils' options, and have an impact on councils' ability to invest in pooled funds, particularly pooled property funds, while encouraging a short-term view and prioritising holding cash
20. Alongside the consultation CIPFA has published an additional document "Treasury Management in the public services guidance notes for local authorities". This is an extract from an existing document and shows tracked changes compared to an earlier published version which makes it easier to understand than the documents published with the Prudential Code consultation. It is clear that it is a guidance document that lays out CIPFA's view of good practice on specific technical matters. The consultation document highlights the material changes to the guidance and the final consultation question (11) refers to the changes proposed.
21. The earlier consultation proposed that each local authority should be mandated to set up a dedicated Treasury Management committee. We are pleased that CIPFA has listened to views expressed on this and that this proposal has been dropped.

### **Next steps**

22. Members are asked to approve the draft consultations responses appended to this report, subject to any amendments agreed at the meeting.
23. Officers will make any amendments to the draft responses and arrange submission to CIPFA.

**Implications for Wales**

24. The Codes will affect the whole UK. Officers have held discussions on the impact of the proposed changes with colleagues in Associations in the rest of the UK.

**Financial Implications**

25. The work covered in this paper is included in the LGA's core budget.