

The Prudential Code for Capital Finance in Local Authorities consultation: LGA response

November 2021

About the Local Government Association

1. The Local Government Association (LGA) is the national voice of local government. We are a politically led, cross party membership organisation, representing councils from England and Wales.
2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.
3. This response has been cleared by the LGA's Resources Board.

General points

4. This consultation is the second stage of the process for reviewing the Prudential Code for Capital Finance in Local Authorities, following on from the consultation on principles undertaken earlier this year. It is being undertaken in parallel with a similar process for the Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes. The LGA responded to the earlier consultations ([Prudential Code](#) and [Treasury Management Code](#)) and our comments on the current consultations should be considered in the context of those earlier comments.
5. In the earlier consultation it was 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 to the code. We also argued that these changes were out of proportion to the perceived problem that they sought to address which had already been addressed by regulatory and other changes elsewhere such as with the [Government's statutory investment guidance in 2018](#) and revised [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](#).
6. The current consultation 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 and we ask CIPFA to reconsider. If these changes stand they could cause confusion and have a far-reaching and unintended impact on councils' stewardship of public money. 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.

7. The draft codes and other documents published in the consultation when taken together appear to rule out local authorities investing in the property sector at all 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.
8. It is also possible to interpret the proposals 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.
9. 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](#).
10. The “Early Guidance on Investment Categories” and “Early Guidance on why authorities should not borrow to invest” are extracts from a further new or unpublished guidance document. Without seeing the whole document, it is hard to be clear on how these fit in with the Code. It is also not clear whether they form part of the consultation or if they have been included for some other purpose.
11. The “Local Authority Investment Classes Mapped to the Main Regulatory Requirements” looks like a standalone document but once again it is not clear whether it forms part of the consultation.
12. 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.
13. 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 three 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.

14. 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.

Individual questions

15. As outlined in the foreword to the code, the text of the code is divided into sentences and paragraphs in bold types and sentences and paragraphs in standard type. Only the words in bold type are formally part of the code, the words in standard type are only “part of the Prudential Code insofar as they assist in interpreting the Prudential Code”. We would question whether this arrangement is widely understood or even necessary; the practice is not used for the Treasury Management Code. However, assuming this arrangement is to stand, where appropriate our responses will comment on whether the words being consulted on should be “bold” or standard”

Question 1: Do you have any comments or observations on the amendments to the code relating to new Objective for proportionate commercial investments? (Prudential Code para 1(f))

16. , We supported the inclusion of proportionality in the objectives of the code.

Question 2: Do you have any comments or observations on the amendments to the code relating to the inclusion the legal status of the code in Chapter 3? (Prudential Code para 12)

17. As drafted, the new paragraph 12 outlines the legal position of the code. This is already widely understood and is defined by legislation. The words are in standard typeface and so do not form part of the code as such but are just explanatory. In our response to the first consultation, we stated that while we had no major objection, it “does seem to be an unnecessary complication. The status of the code is defined by legislation and could be changed by legislation. Including the current status within the code makes it less stand alone and timeless”. The new words as drafted confirm our earlier opinion.

Question 3: Do you have any comments or observations on the amendments to the code relating to the reference to environmental sustainability in contents of Capital Strategy? (Prudential Code para 24).

18. The proposed change is to replace the words “including links to the authority’s policies on capitalisation” with “including how capital expenditure is prioritised in relation to the strategic priorities and policies of the authority, such as environmental sustainability”. In our response to the first consultation, we commented that this should already be the case and so we supported it. This remains the case.

Question 4: Do you have any comments or observations on the amendments to the code relating to Capital Strategy's requirement to summarise investments into treasury management, service and commercial purposes? (Prudential Code para 24)

Question 5: Do you have any comments or observations on the amendments to the code relating to the greater clarity on commercial and service investments in the Capital Strategy, including limits, and compliance with requirement not to borrow to invest for return? (Prudential code 24)

19. The amendments for both question 4 and 5 add significant detail to what should be included in the capital strategy. Including more information can be supported, however, the definitions need to be clear, understood and accepted.

Question 6: Do you have any comments or observations on the amendments to the code relating to the explicit requirement to set and monitor the treasury management prudential indicators in the TM Code LA Guidance? (Prudential Code para 43)

Question 7: Do you have any comments or observations on the amendments to the code relating to the quarterly monitoring of prudential indicators as part of normal budget monitoring reports? (Prudential Code para 43)

20. The amendments referred to in both questions 6 and 7 are in bold typeface and so form part of the code. The additional requirement is to monitor quarterly (rather than for an unspecified timescale) and for the reporting of the monitoring to be part of the integrated revenue, capital and balance sheet monitoring. The setting and regular monitoring of these indicators are clearly very important, but we would question whether defining how and when this is done in this detail and as part of the code itself will allow this to be done in an optimal way.

Question 8: Do you have any comments or observations on the amendments to the code relating to the revision of 'Paragraph 45'? (Prudential Code para 48 – 52)

21. In our response to the earlier consultation, we argued that the proper place for a direction that local authorities should not borrow to invest primarily for a financial return is the government's statutory investment guidance, and that revisions to that guidance for England in 2018 sought to do just that. We also expressed concerns that the wording proposed in the earlier consultation was unclear. These new paragraphs are a mix of bold typeface (51) and standard typeface (49, 50 and 52). The paragraph in bold makes it clear that "An authority must not borrow to invest primarily for financial return". While we continue to question whether the Prudential code is the right place for this statement, we accept that the wording now proposed is at least clear and therefore an improvement on what was proposed in the earlier consultation.

22. Paragraph 52 goes into detail of the new PWLB lending terms. Again, we question whether this is appropriate for the Prudential Code as it means that the Prudential Code will need to be revised the next time that the PWLB alters its lending terms. In addition the words are misleading and they ignore the clauses in the PWLB lending terms on eligibility for access refinancing loans, supported by clarification in the [PWLB guidance](#) that "The government recognises the benefits

of having ready access to the PWLB for refinancing. The PWLB will therefore lend for this purpose even if the local authority is planning activity that makes them otherwise ineligible for PWLB support". We therefore suggest that this paragraph is reviewed and either amended or preferably deleted as superfluous in the light of these comments.

Question 9: Do you have any comments or observations on the amendments to the code relating to authorities with commercial financial investments who expect to borrow: annual strategy to review options for exiting commercial investments? (Prudential Code para 53).

23. Paragraph 53 is a mix of standard and bold typeface. The words in bold (so part of the code) instruct local authorities with a need to borrow to review options for investments first and "should not take new borrowing if financial investments for commercial purposes can reasonably be realised". The words in standard typeface (and so explanatory only) are that "Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments".
24. There is a major concern that the instruction in this paragraph, coupled with the other documents that were published alongside the consultation, will encourage local authorities to take sub optimal decisions with regard to investments and so make significant unnecessary losses. If the intention is not to encourage a fire sale of investments (and it should not be) then:
 - 24.1. the words currently in standard type should be made bold and so included in the code.
 - 24.2. The word "immediately" should be deleted. A time limited word like this has no place in what is a permanent code. If authorities are not required under the code to sell existing investments now, then that should hold in the medium and long term as much as in the short or immediate term. The inclusion of the word "immediately" adds a further layer of confusion. It implies either that there will be a point when the "immediate" period is over at which point local authorities are required to sell all investment assets or that a further revision of the code will be made once this "immediate" period is over and a decision made as to whether authorities are being instructed to sell their assets under the code. Neither of these scenarios are acceptable.

Question 10: Do you have any comments or observations on the amendments to the code relating to the new prudential indicator for net income from commercial and service investments as % of net revenue stream? (Prudential Code para 81-85)

Question 11: Do you have any comments or observations on the amendments to the code relating to the Investment Prudential Indicators to be reported together with investment indicators under Statutory Investment Guidance? (Prudential Code para 83).

25. Questions 10 and 11 cover technical changes to the calculation of prudential indicators and indicators of affordability. In our response to the earlier consultation, we emphasised that the views of individual local authorities and of

finance practitioners within the sector on these proposed changes will be important. This response still holds.

Question 12: Do you have any comments or observations on the amendments to the code relating to inclusion of Heritage Assets in definition of CFR? (Prudential Code para 90)

26. The views of practitioners and of authorities with significant heritage assets will be important on this point.

Question 13: Do you have any comments or observations on the amendments to the code relating to the new definition of Commercial Property? (Prudential Code para 91)

27. This definition is in standard typeface and is therefore just explanatory. We have no significant comments on this. The definition appears to be reasonable.

Question 14: Do you have any comments or observations on the amendments to the code relating to the removal of the deduction for interest and investment income from definition of Financing Costs? (Prudential Code para 94)

28. This paragraph is in standard typeface and is therefore just explanatory. We have no significant comments on the proposed deletion.

Question 15: Do you have any comments or observations on the amendments to the code relating to the revised definition of Investments (to include non-financial assets held primarily for financial return)? (Prudential Code para 95)

29. This is a new paragraph and is in standard typeface so it is therefore just explanatory rather than formally part of the code. This seems to cover the same ground as the additional documents published alongside the code (see general points above) but as we have already stated it is not clear how these interrelate. It is therefore difficult to understand exactly what is being proposed.

Question 16: Do you have any comments or observations on the amendments to the code relating to the clarification that Net Revenue Stream excludes capital grants and other items? (Prudential Code para 96)

30. These additions are in standard typeface and so are therefore just explanatory and not part of the code. We agree it would be correct to exclude capital grants from the net revenue stream. It is not clear whether the reference to the other items (contributions and donated assets) is also just capital; we expect that this is the intention which can be supported, but it could be made clearer. We suggest that it is amended to read “capital grants and other capital contributions including donated assets”.

Question 17: Please detail any other comments on amendments to the code or further observations.

31. Further comments have been made in the general points section of this response.

Contact:

Bevis Ingram

Senior Adviser Finance

Phone: 079 2070 2354

Email: bevis.ingram@local.gov.uk