Resources Board

2 March 2022

Review of CIPFA Prudential Code and Treasury Management Code

Purpose of report

For information.

Summary

This report provides a summary of reviews of the final published versions of the CIPFA Prudential Code and Treasury Management Code in the light of concerns raised by members of Resources Board and included in the LGA's consultation responses. The most significant practical concerns raised in the LGA's responses have been addressed, as well as some more minor issues. This means that the anticipated major negative impact of the new codes is now unlikely to happen.

Is this report confidential? Yes ☐ No ☒

Recommendation

That Members of the Resources Board note this update.

Action

Officers proceed as directed.

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Background

1. Members will recall that last year the Chartered Institute of Public Finance and Accountancy (CIPFA) consulted on changes to the Prudential Code for Capital Finance in Local Authorities (the "Prudential Code") and the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (The "Treasury Management Code").

2. The LGA's responses to the consultations (Prudential Code response and Treasury Management Code response) on the proposed new wording for the codes was discussed at the November meeting of the Resources Board. At the meeting Members raised significant concerns that are reflected in the responses. The overall concern was that the proposed changes to the code would lead to confusion and unintended consequences which included:

   - Preventing investing in property where there was any financial return even if this was not the primary purpose
   - councils would have to undertake a "fire sale" of investments
   - councils with investments would be unable to properly manage their portfolios, and
   - councils' treasury management and associated activities would be severely curtailed, especially if they were net borrowers
   - concerns with code objectives

3. LGA officers have held several discussions with CIPFA on the proposed changes to the codes. In December CIPFA published final revised versions of the codes. These are now available for a fee via the CIPFA website. It is the view of LGA officers that CIPFA made changes to the final versions of the codes to reflect our concerns meaning that the anticipated major negative impact of the new codes is now unlikely to happen.

Concern: Investing in Property

4. The proposed code could have been interpreted as ruling out local authorities investing in the property sector at all for a financial return, even if this was not the primary purpose of the investment. This could have had an impact on councils investing in property for regeneration and service purposes. The Prudential Code now makes it explicit that borrowing to fund investments that are primarily for a financial return is not prudential rather than any borrowing where there is any financial return. The new code explicitly states (para 51): "In order to comply with the Prudential Code, an authority must not borrow to invest primarily for financial return." In our view, the changes made to the 2017 version of the code, coupled with the Government's statutory investment guidance

(2018) and the PWLB lending terms introduced last year had already addressed this issue. So the proposed change to the code was not needed. However, the wording in the new code is clearer than the previous versions which relied on interpretation of the words “borrowing in advance of need purely in order to benefit from the investment of the sums borrowed”.

Concern: “Fire sale” of investments

5. The code could also have been interpreted as saying that councils with any investments should sell them before being able to borrow for service capital purposes. Paragraph 53 of the code now states (in bold so it is part of the code) that “Authorities with existing commercial investments (including property) are not required by this Code to sell these investments”. The draft code could have been interpreted implying that councils would be required to sell at later date. This potential implication has been removed from the code.

Concern: Managing portfolios

6. We raised concerns that the changes in the code affecting investment in property generally could have an impact on legacy investments in property for regeneration and service purposes which now generate a return. The consultation version of the code included a direct reference to managing regeneration and service investments with commercial investments. This has been removed from the final version, which is helpful.

7. The code also now states that “Authorities with commercial land and property may also invest in maximising its value, including repair, renewal and updating of the properties”. The addition of “maximising value” recognises that the proper management of an existing investment portfolio is a legitimate activity.

Concern: Restriction of Treasury Management activity

8. It was possible to interpret the definitions in the Prudential Code as saying certain treasury management activity, particularly investment in pooled property funds, should be classified as commercial investment and so be caught by other provisions within the Prudential Code, which would clearly have a major impact.

9. In response, a new bullet point has been added to paragraph 95 of the Prudential Code (definition of treasury management). This states that:

   “Treasury investments may also arise from other treasury management activity that seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments”

10. This means that if investments are undertaken as treasury management activity, then they (by definition) count as treasury management activity. This means they are not caught by the definition of commercial investment in the Prudential Code.

11. The serious concern expressed in our response to the Treasury Management Code consultation related to how the code interacted with the proposals in the Prudential Code

and in particular the definitions of different types of investments. The changes made to the Prudential Code outlined above address these concerns.

Concerns with code objectives

12. The consultation included a proposed new objective to the Prudential Code that "the risks associated with investments for commercial purposes are proportionate to their financial capacity…". While agreeing with proportionality generally, we objected to this statement as this unduly focussed on commercial investments which was not appropriate for the prudential code. The final version has been revised in response to our comment to say "the risks associated with investments for service and commercial purposes are proportionate to their financial capacity". This general point is more appropriate.

Concerns not addressed

13. Our response raised concerns about some of the comments about access to PWLB borrowing that are now in the code that we believed to be incomplete and so potentially misleading. The comments in the code ignore the clauses in the PWLB lending terms on eligibility for access refinancing loans. Our points have not been addressed. However, it is unlikely that this will have a major impact as practitioners will in any case have to refer directly to the PWLB's published rules in order to access PWLB.

14. We raised concerns about new requirements in the code for quarterly monitoring and reporting of indicators. We argued that "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." We understand from discussion that similar points were made in a number of other consultation responses. CIPFA informally stated that in response they were going to make this "voluntary". The change made is that the code no longer specifies where the monitoring should be reported to, while still stating that it should be done quarterly. While the new wording in the code is not ideal, this probably gives enough flexibility to enable councils to avoid major problems with it.

Other codes in the prudential framework

15. The CIPFA codes are only two (of four) codes that make up the Prudential framework for local authority capital finance. A DLUHC consultation on changes to Minimum Revenue Provision closed on 8 February. The LGA's response was cleared by Resources Board Lead Members and raised several concerns about unintended consequences of the proposed changes. Discussions with DLUHC on mitigation are continuing. A further review followed by consultation by DLUHC on any changes arising to the Statutory Investment guidance (the fourth code in the framework) is expected later this year. It would be expected that any review of the investment guidance would take account of the new CIPFA codes and with the new PWLB lending arrangements published in 2020.

Implications for Wales

16. The CIPFA Codes will affect the whole UK. We are in regular contact with the Welsh LGA and have discussed the impact of the new codes with colleagues in the Associations in the rest of the UK.

Financial Implications

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

Next steps

18. Members are asked to note this update.