CIPFA\

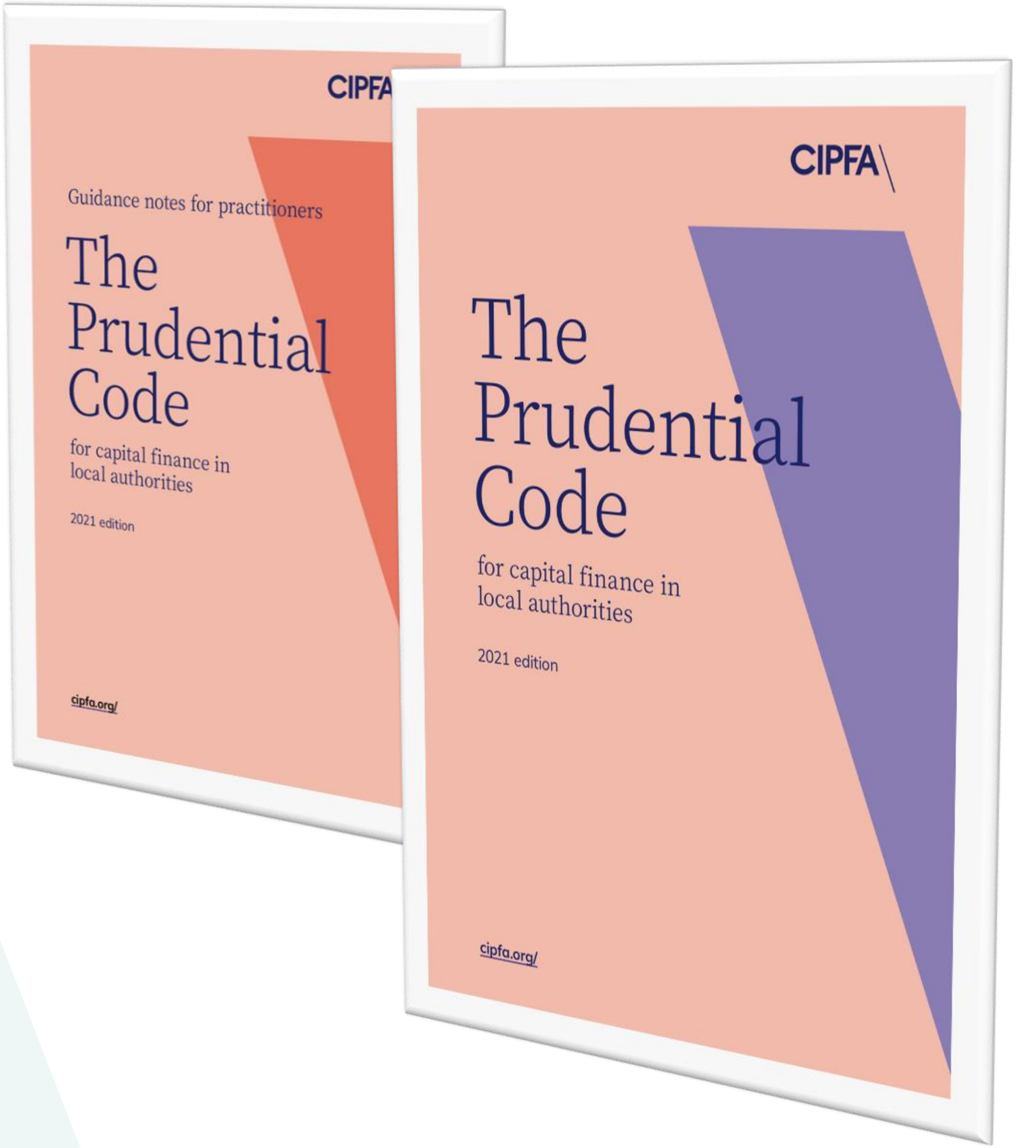
Prudential Code for Capital Finance in Local Authorities

Jackie Shute FCPFA, Public Sector Live

The Chartered Institute of
Public Finance & Accountancy

Agenda

- Background to Capital Financing
- Emerging Behaviours
- Links to Treasury Management Code
- Content of the Prudential Code
- Levelling Up Bill 2022
- Summary

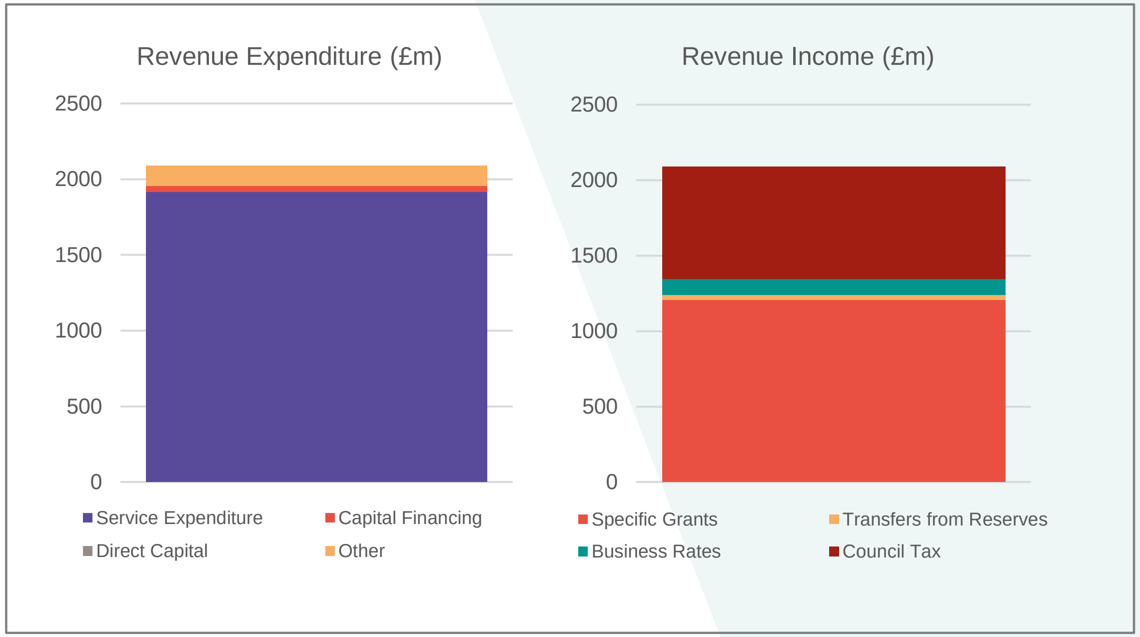


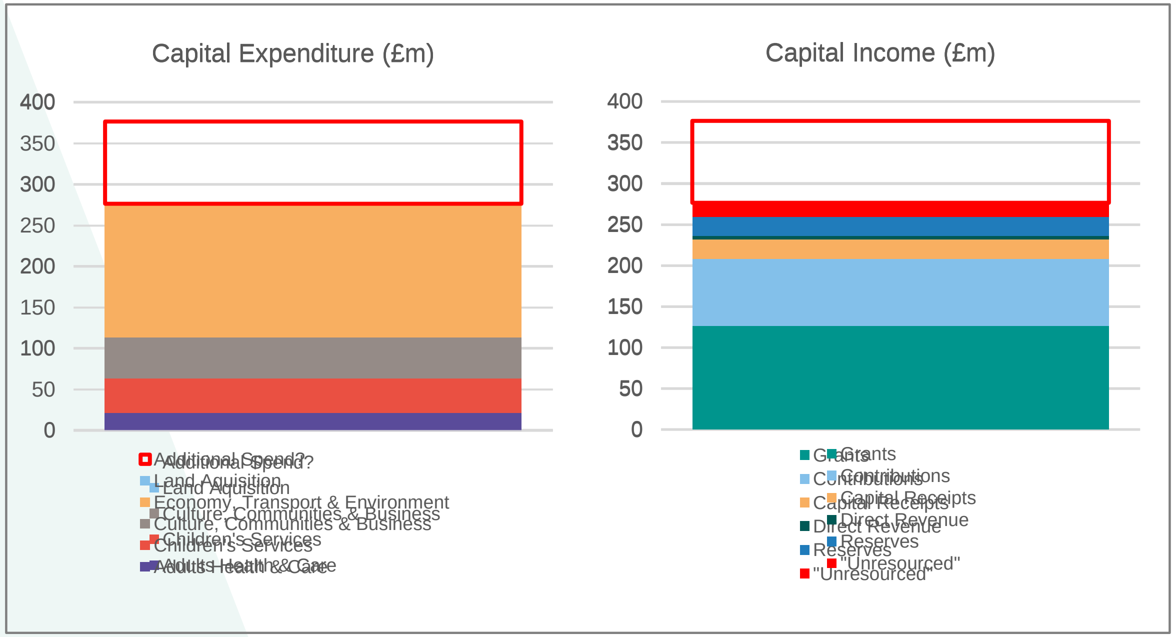
Local Authority Financing Controls

Requirement to maintain a balanced budget –
Local Government Act 1992 s32 (a)

Hierarchy of legislative controls, including
Guidance from Secretary of State

> 21. An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income.





CIPFA

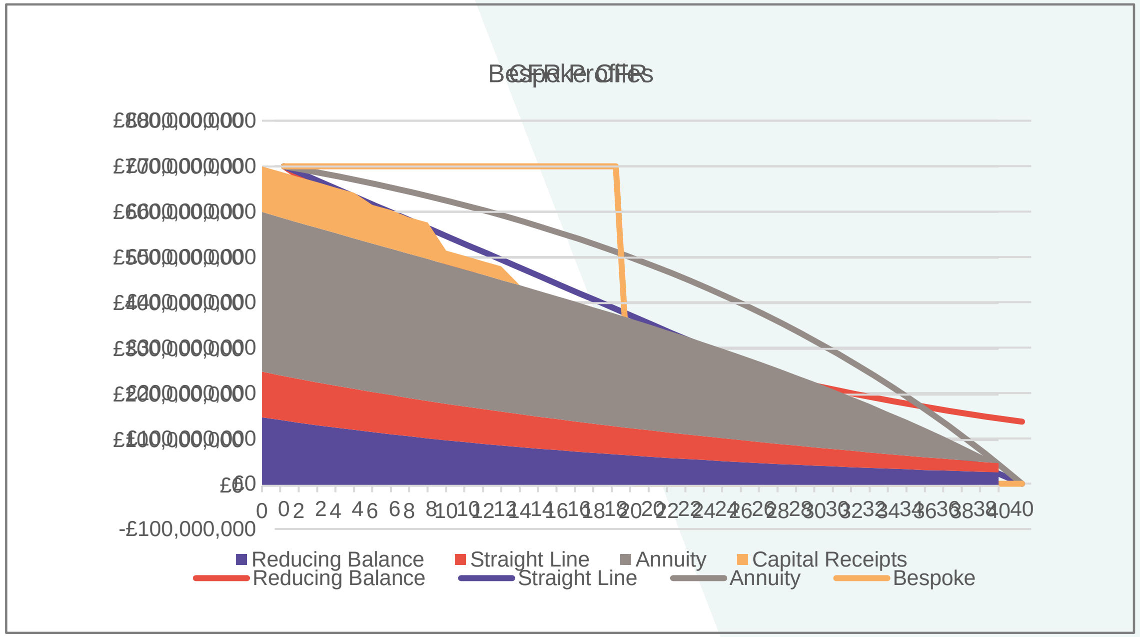
The Capital Financing Requirement

- **Capital Financing Requirement** (CFR) measures cumulative unresourced capital expenditure
- Must be amortised through the revenue account over a period of time (exceptions for HRA) – the **Minimum Revenue Provision** (MRP)
- Capital receipts can be applied to reduce the unresourced amount
- Includes the outstanding liabilities in respect of finance leases / PFI

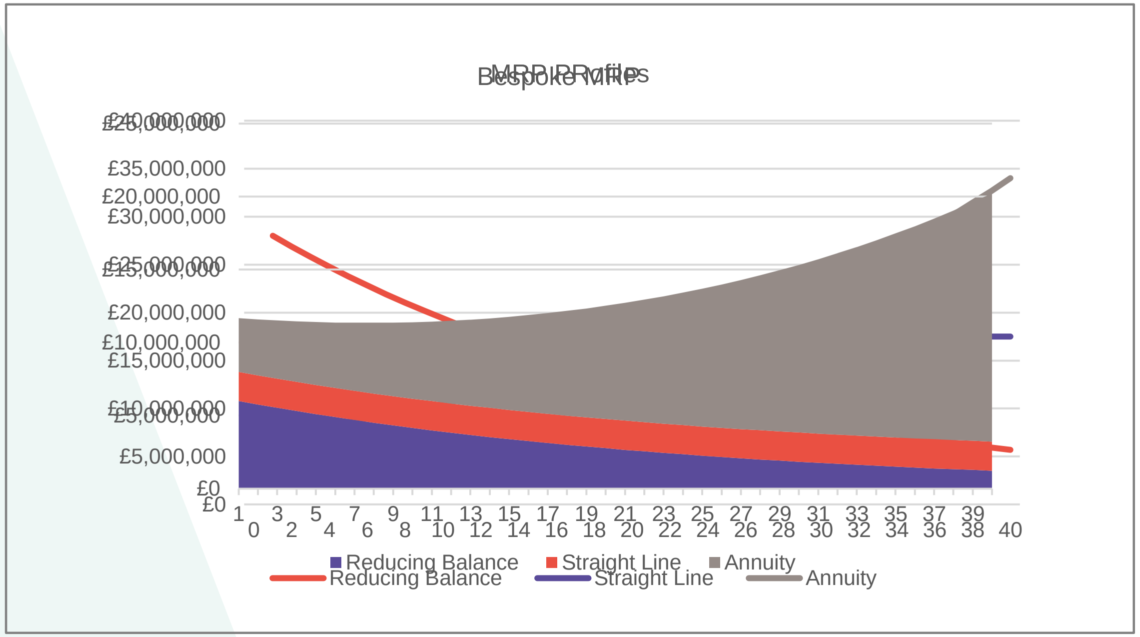
	2022/23	2023/24	2024/25
Opening CFR	780	789	780
Prudential Borrowing	39	24	0
Minimum Revenue Provision	-30	-33	-42
Closing CFR	789	780	738

Resourcing the “Unresourced” Capital Expenditure

- Must be an amount “…which [the Local Authority] considers to be prudent.”
- Alignment of the period over which MRP is charged with period over which the benefits of the capital expenditure provides benefits
- Three main options recommended, but does not rule out alternatives



Source: PSL

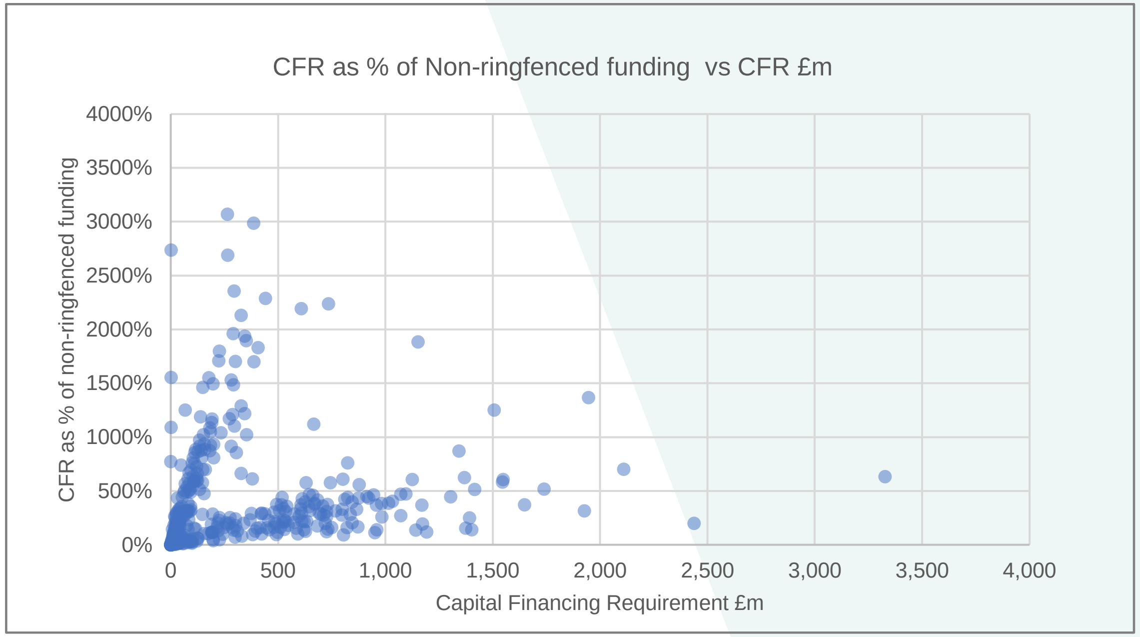


Source: PSL

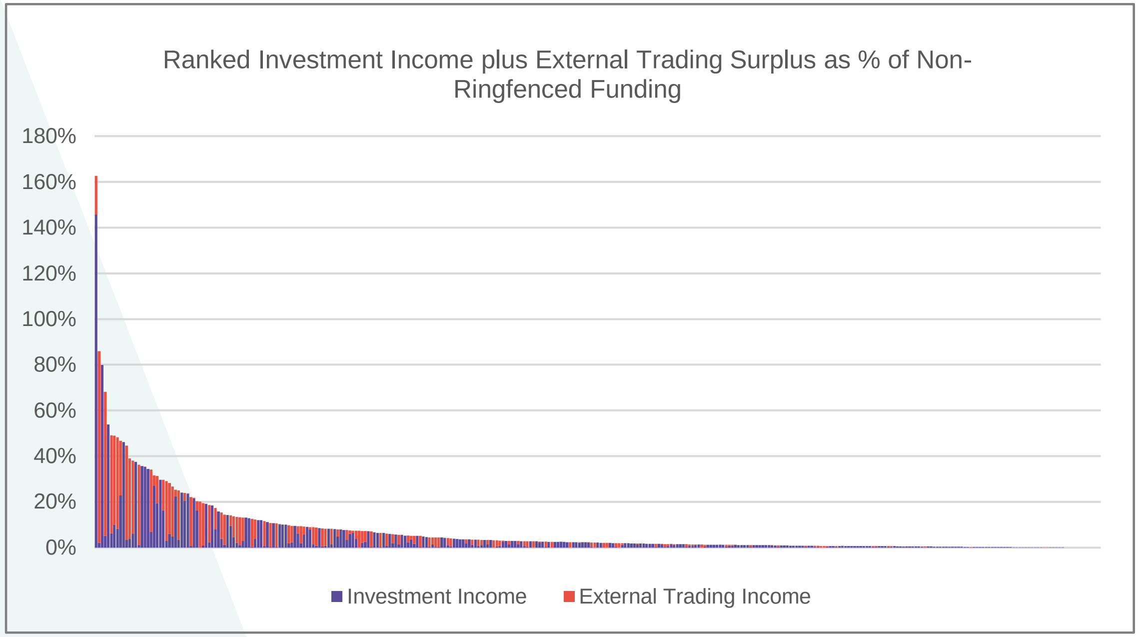
Emerging behaviours

(Source: Local Authority Capital Framework: planned improvements)

- Significant increase in commercial investment
- Excessive debt taken in pursuit of commercial income
- Taxpayers money expose to undue risk
- Opaqueness of some complex capital transactions (income strips, derivatives)
- Creative MRP approaches



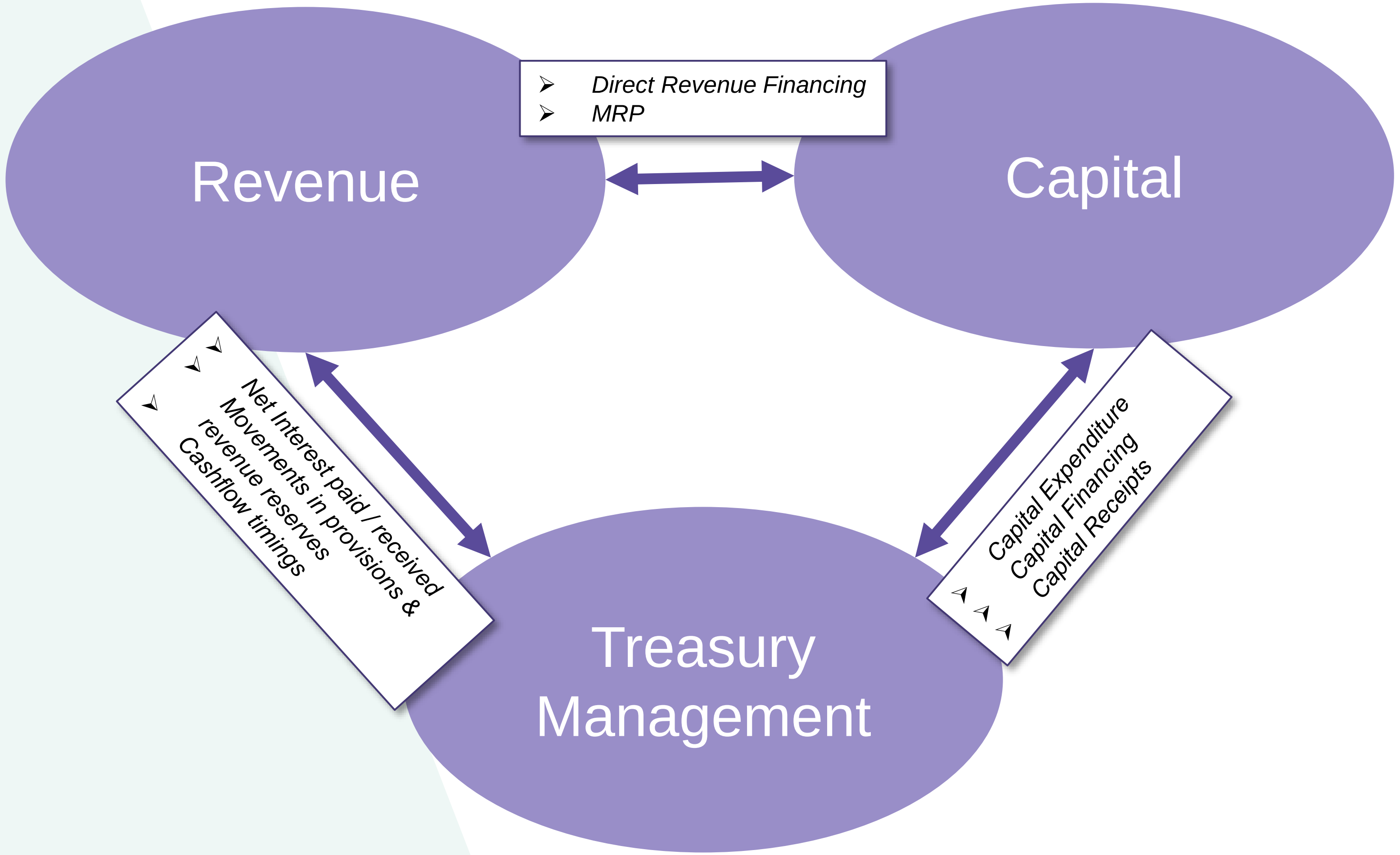
Source: PSL



Source: PSL

Links with Treasury Management Code of Practice

- Treasury Management isn't just about "Prudential Borrowing"
- It's the management of the organisation's entire cashflows
- Treasury Management Prudential Indicators
    - Liability Benchmark
    - Maturity Structure of Borrowing
    - Long term treasury management investments
    - Interest rate exposures
    - Credit Risk
    - Price Risk



CIPFA

Objectives of Prudential Code

To ensure, within a clear reporting framework, that:

- a local authority’s capital expenditure plans and investment plans are **affordable** and **proportionate**
- all external borrowing and other long-term liabilities are within **prudent** and **sustainable** levels
- the risks associated with investments for commercial purposes are proportionate to their financial capacity, and
- treasury management decisions are taken in accordance with good professional practice

How is it demonstrated that the objective are achieved?

- Capital Strategy
    - High level overview of how capital expenditure, capital financing, investments and treasury management decisions contribute to the delivery of corporate objectives
        - Capital Expenditure
        - Debt, Borrowings, Investments & Treasury Management
        - Investments for Commercial or Service Purposes
        - Other Long Term Liabilities
        - Knowledge & Skills

How is it demonstrated that the objective are achieved?

Through a series of Prudential Indicators

- Set and revised alongside processes established for setting and revising the budget
- Indicators for prior years should be taken from Statement of Accounts
- Consider local indicators
- Treasury Management Prudential Indicators set out in TM Code
- Establish processes to monitor and report performance against Prudential Indicators on a **quarterly basis**

The Prudential Indicators - Prudence

Considerations for Prudence

- **Borrowing to invest primarily for financial return is not considered prudent**
- Therefore rules out financing investments from prudential borrowing unless relevant to functions and financial returns are incidental to main purpose
- Whilst not required to sell existing commercial investments, prior to borrowing new loans, **LAs should review options for exiting financial investments**
- Any LAs with statutory ring fenced accounts (e.g. HRA or Police Fund) should report indicators for Prudence separately for those Accounts

CIPFA

The Prudential Indicators - Prudence

Capital Expenditure

- Estimates of capital expenditure

	2022/23 £m	2023/24 £m	2024/25 £m
Capital Expenditure	217	159	181

- Estimates of capital financing requirement

	2022/23 £m	2023/24 £m	2024/25 £m
Capital Financing Requirement	789	780	738

The Prudential Indicators - Prudence

External Debt

- Authorised Limit

	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	790	800	770
Other LT Liabilities	160	150	140
Total	850	840	800

- Operational Boundary

	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	720	720	690
Other LT Liabilities	130	120	110
Total	850	840	800

- Gross debt does not exceed capital financing requirement

	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	284	276	266
Other LT Liabilities	143	132	120
Total	427	408	386
Capital Financing Requirement	789	780	738

The Prudential Indicators - Affordability

Considerations for Affordability

- Ensure that level of investment in capital assets being proposed means that the total capital investment of the LA remains within sustainable limits
- Consider the financial position, including all of the resources currently available and estimated for the future together with totality of its capital, borrowing and investment plans, income and expenditure forecasts and risks
- Considered against any ringfenced resources available to fund borrowing
- Ensure that the revenue implications of capital finance are properly taken into account in the option appraisal process, capital programme and MTFS

The Prudential Indicators - Affordability

- Estimates of Financing Costs to Net Revenue Stream

	2022/23	2023/24	2024/25
Ratio of financing costs to net revenue stream	4.6%	4.6%	4.2%

- Estimates of net income from commercial and service investments to Net Revenue Stream

	2022/23	2023/24	2024/25
Ratio of financing costs to net revenue stream	4.6%	4.6%	4.2%

Levelling Up & Regeneration Bill 2022 s71

- Secretary of State may give Risk Mitigation Directions if Trigger Event occurs
- Trigger events occur when Risk Threshold are breached
- Risk Thresholds are breached when Capital Risk Metrics breach the specified threshold
- Capital Risk Metrics
    - Total debt / financial resources
    - Proportion of assets held wholly or mainly to generate financial return
    - Proportion of debt which is not from central or local government
    - Amount of minimum revenue provision charged in a year
    - Any other metrics specified by the Secretary of State
- Risk Mitigation Directions may be a borrowing limit or other specific action

Potential changes to Minimum Revenue Provision

- Consultation launched November 2021
- Changes to be made to Local Authority Capital Financing Regulations 2003 No.3146
- Addressing:
    - LAs which exclude a proportion of their CFR from the MRP calculation
    - LAs which apply capital receipts to the MRP amount

Summary & Conclusions

- Key governance Codes ensuring prudence and risk management are at the heart of capital strategy and treasury decision making
- Updated emphasis on reducing exposure to commercial investments
    - No longer resource investments in commercial assets from prudential borrowing
    - New considerations on proportionality
- New requirements for quarterly formal Prudential Indicator monitoring
- Forthcoming changes to further strengthen framework
    - Levelling Up & Regeneration Bill
    - MRP changes

Appendices

CIPFA

Legislative Context

- Primary Legislation
  - Local Government Act 2003 s15

15 Guidance

(1) In carrying out its functions under this Chapter, a local authority shall have regard—

(a) to such guidance as the Secretary of State may issue, and

(b) to such other guidance as the Secretary of State may by regulations specify for the purposes of this provision.

(2) The power under subsection (1)(b) is not to be read as limited to the specification of existing guidance.

- Secondary Legislation
  - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 No. 3146

Code of practice

2. In complying with their duties under section 3(1) and (2) (duty to determine affordable borrowing limit), a local authority and the Mayor of London 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(8).

CIPFA

Other relevant legislative context

- Primary Legislation
  - Local Government Act 2003 s21

21 Accounting practices

(1) The Secretary of State may by regulations make provision about the accounting practices to be followed by a local authority, in particular with respect to the charging of expenditure to a revenue account.

[F1 (1A) The Secretary of State may issue guidance about the accounting practices to be followed by a local authority, in particular with respect to the charging of expenditure to a revenue account.

(1B) A local authority must have regard to any guidance issued to it under subsection (1A).]

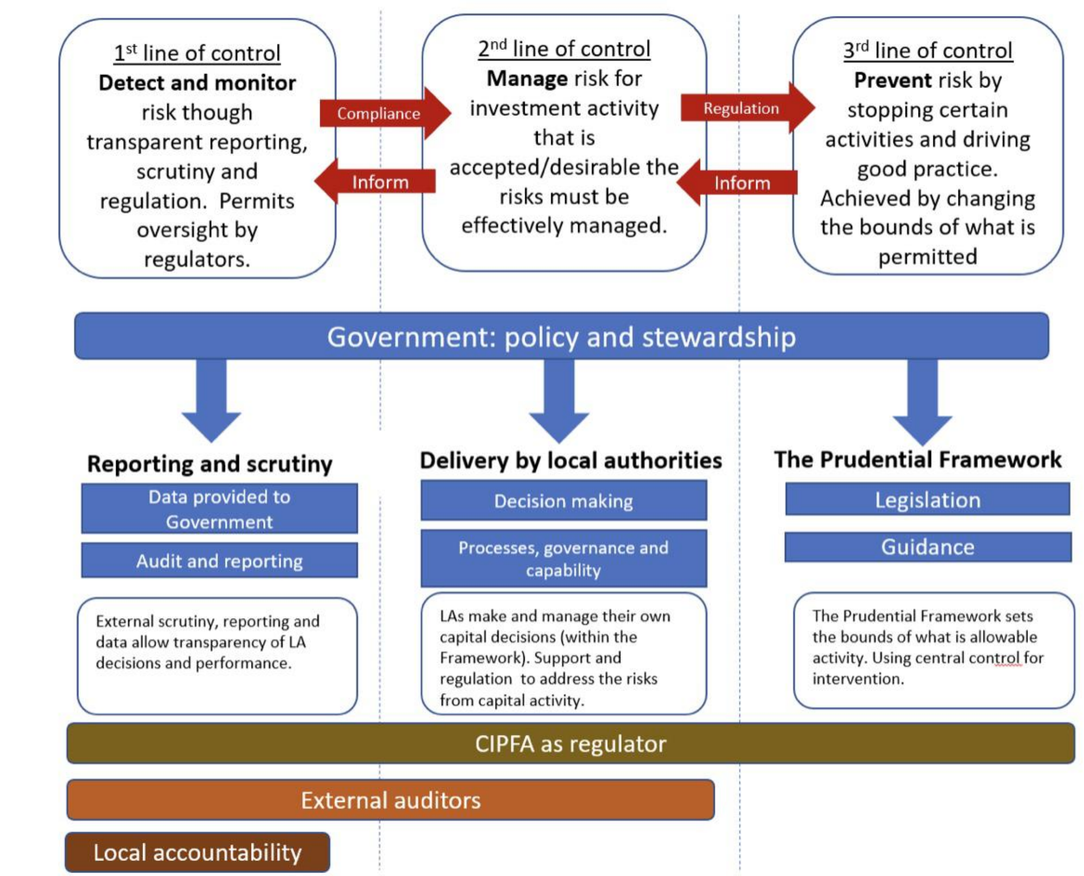
- Secondary Legislation
  - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 No. 3146 s28 (as amended)

"**Determination of minimum revenue provision**

28. A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.";

- Guidance from Secretary of State
  - Statutory Guidance on Minimum Revenue Provision
    - Sets out the options for charging MRP commensurate with asset life
    - Includes rules around MRP on investment properties, capital loans and share capital

Three Lines of Control Model for Strengthening the Capital System



Source: Local Authority Capital Finance Framework: Planned Improvements July 2021

Further Information

- “Local Authority Capital Finance Framework: planned improvements”
  Policy Paper July 21
- “Local Authority Financial Resilience”
  Commons Library Research Briefing November 21
- “Local Government in England: Capital Finance“
  Commons Library Research Briefing November 21
- “The Local Government Finance System in England: overview and challenges”
  National Audit Office Report November 21

CIPFA

Biography

Jackie Shute, Head of Local Authority Strategy, Public Sector Live Ltd

Jackie started her Local Government treasury career over 25 years ago and, since qualifying with CIPFA in 2001, Jackie has spent considerable time heading up treasury teams in Local Authorities, as well as being a treasury advisor for a number of years. Jackie has worked closely with CIPFA since 2008, as a contributor to the TIS volumes on capital finance as well as a member of the Treasury Management Network Advisory Group. Jackie co-founded Public Sector Live in 2011 with the aim of providing LAs with tools to manage their treasury risk profiles and empower decision making. Jackie and colleagues developed and delivered CIPFA's Treasury Management Risk Studies from 2010, introducing the concept of the Liability Benchmark from 2011. Jackie co-authored CIPFA's Treasury Risk Management Toolkit in 2012 and contributed to the HRA Self Financing Guide, in respect of the treasury management implications. Jackie is now Head of Local Authority Strategy at Public Sector Live where Liability Benchmarking software tools have been provided since 2012, and PSL continue to work with CIPFA on treasury management software to ensure the spirit of guidance is provided in practice.

pslive.co.uk
jackie.shute@pslive.co.uk

CIPFA's Liability Benchmark Implementation Service

Implementing CIPFA Best Practice Treasury Risk Management

- FREE service to all Local Authorities
- On-boarding done for you
- Tools to update and refine projections
- One-to-one training sessions
- Bespoke step-by-step guide to your position

Register here

https://www.pslive.co.uk/Liability-Benchmark-Registration

TreasuryLive

Transform your Treasury Operations

Exclusively endorsed by CIPFA to deliver best practice and Code compliant tools

- Cloud based treasury risk management system
- One version of the truth
- Real time risk analytics

Deal Recording

Accurately record all treasury transactions

- Every Local Authority transaction type available
- Linked to market data and money market fund feeds
- All round visibility of cash flows

Cash Management

Robust and complete cash flow projections

- Daily cash reconciliations
- Long term forecasting
- Full audit trails

Insightful Reporting

Elegant and insightful visuals

- Back office reconciliations
- Management dashboards
- Cash flow forecasting
- Call account and money market fund reconciliations
- Interactive insights to your evolving treasury portfolios

Liability Benchmarking

Only borrow what you need

- Achieves the requirements of the CIPFA Treasury Code
- Understand your Authority's long-term projections
- Enhance your decision making
- Develop your treasury management strategy

Risk Analysis

Ensuring risk management at the heart of decision-making

- Quantify revenue risk exposures
- Best in class risk reporting
- Accessible yet powerful suite of tools
- Essential for treasury budget setting and monitoring

Book a demo at https://pslive.co.uk/PSLive-Bookings
Contact us at support@pslive.co.uk for more information

CIPFA The Chartered Institute of Public Finance & Accountancy

TreasuryLive

PSLive Giving information a voice