

**Society of District Council Treasurers**

**Response to CIPFA: The Prudential Code for Capital Finance in Local Authorities – Consultation (Round 2)**

**Introduction**

The Society of District Council Treasurers (SDCT) was formed in 1974 and represents the 181 district council finance functions in England. The Society provides a forum for members to share expertise on financial issues affecting district authorities. It also enables districts to speak with a united voice; as a Treasurers’ Society it is recognised as a key local government stakeholder by central government and the Local Government Association.

The SCDT welcomes the opportunity to comment on this consultation.

**Overview**

We reiterate the points made in the earlier consultation that by looking at the Prudential Code in isolation you are ignoring the reasons why local authorities, and district councils in particular, have completed more property investments in recent years.

CIPFA are potentially cutting off another income stream to authorities that are already battling to deal with the reduced Government funding, Council Tax referendum limits, restrictions on charges for other services and increasing demand.

It should not be forgotten that authorities exist to provide key services to their communities and having less income from any source will impact their ability to continue to provide these services.

**Responses to specific questions**

**Question 1: Do you have any comments or observations on the amendments to the code relating to new Objective for proportionate commercial investments?**

The code emphasises the importance of proportionality but the lack of guidance on how this can be calculated will lead to inconsistency and confusion.

The wording *“that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services”* is unclear. What is a plausible loss? How and when should it be identified?

S151 officers have a statutory duty for the proper administration of the financial affairs of an authority and would therefore expect this issue to be addressed within the options appraisal and by carrying out thorough due diligence before any investment decision is made. There is always a judgement which Officers and Members have to take in relation to the Council’s risk appetite, the Prudential Code currently provides the flexibility for this judgement and this should not be changed. It is recommended that this wording is not incorporated within the Code.

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

It is appropriate to include the legal status within the code.

**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?**

This proposal mixes subjective policy related issues within the objectivity of the Prudential Code. The Prudential Code should focus on the objective, financial elements of capital expenditure and not try to widen its remit which could create greater confusion.

**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?**

It would be more appropriate to include this in the Investment Strategy rather than the Capital Strategy.

It should also be noted that some Council are currently debt free but will need to commence borrowing to support their capital programme in future years. It would be helpful to have guidance on the transition from being debt free to being a debt holding authority as some of the treasury management investments will change from being held for treasury management purposes to being held for commercial purposes. This will make year on year comparisons difficult to understand.

**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?**

CIPFA have provided definitions of investments for service purposes and for commercial purposes. It is clear that within the definition of a service investment these are not made with the primary objective of obtaining a financial return. There is also an acceptance that they normally constitute capital expenditure and that it may be appropriate to borrow for them. On the other hand, investment for a commercial purpose is defined as something taken or held primarily for financial return and not linked to treasury management activity or directly part of delivering services.

The consultation acknowledges that some councils hold investments where the purpose is primarily for financial return. The proposed amendments to the Prudential Code will require councils to consider whether it is more appropriate to realise these investments than to borrow for new capital service expenditure. The Code needs to ensure there is the flexibility for councils, as advised by their Chief Finance Officer, to make their own decisions. The fact that there are existing investments held for financial return must not prevent the Council from borrowing for **future** **service** investment. Any financial limits included should therefore be flexible enough to allow the Chief Finance Officer to be able to advise the Council to maintain the level of past investments. The Chief Finance Officer should advise the Council on the limits which provide best value for money to the Council.

**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?**

This requirement will exceed the current arrangements to report at least twice a year. Our concern is that some information required to complete these new reporting requirements (at least quarterly) will not be available in a timely manner. CIPFA propose implementing the Liability Benchmark and also mention balance sheet monitoring. When these are combined with other reporting requirements proposed in the Prudential Code and Treasury Management Codes, it may not be practical to produce value added reporting in the timescales available. We are already aware that many authorities struggle to get periodic reports completed in a timely fashion as their staffing resources have reduced, and also to fit with committee cycles. It often means that reports presented at appropriate committees are out of date for decision making purposes.

If this change is brought in, could the Prudential Code be amended so that full Council approves the various strategies, but monitoring is routinely carried out by a Committee, Cabinet and or the Audit Committee (as determined by a local authority’s Constitution) rather than requiring full Council consideration? Committees would retain the right to report to Council on an exception basis such as when a Prudential Indicator or financial limit has been or is forecast to be breached. The Council will then be able to focus its attention on this strategic matter rather than being bogged down in routine monitoring.

**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?**

We would expect any significant change to be picked up as part of other processes rather than increasing the monitoring burden even further as in the vast majority of cases there are unlikely to be any changes.

**Question 8: Do you have any comments or observations on the amendments to the code relating to the revision of ‘Paragraph 45’?**

As mentioned elsewhere, this looks at this subject in isolation and ignores the potential impact on delivering services. It mentions “which reflects their own risk appetite” but the rest of the paragraph is advising authorities to be risk averse.

**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?**

This is potentially very damaging as it highlights the danger of looking at this subject in isolation and not recognising that income earned from commercial investments is funding services due to reduced income from other streams.

The Code needs to ensure there is the flexibility for Councils, as advised by their Chief Finance Officer, to make their own decisions. The fact that there are existing investments held for financial return must not prevent the Council from borrowing for **future** **service** investment. Any financial limits included should therefore be flexible enough to allow the Chief Finance Officer to be able to advise the Council to maintain the level of past investments. The Chief Finance Officer should advise the Council on the limits which provide best value for money to the Council.

**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?**

No, clarity has been added to explain what is meant by commercial and service investments.

**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?**

No.

**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?**

No.

**Question 13: Do you have any comments or observations on the amendments to the code relating to the new definition of Commercial Property?**

This adds much needed clarity.

**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?**

If CIPFA are seeking to produce a gross financing cost, then it would seem appropriate to remove this item.

**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)?**

There remain concerns about mixing up what has traditionally been capital expenditure (acquisition of assets and service investment) with investments made for treasury management purposes.

This will be tricky for local authorities who are going to undertake borrowing for the first time after being debt-free. Investment will transfer from treasury management purposes to commercial purposes once borrowing commences.

The proposed amendments to the Prudential Code will require the Council to consider whether it is more appropriate to realise these investments than to borrow for new capital service expenditure. The Code needs to ensure there is the flexibility for Councils, as advised by their Chief Finance Officer, to make their own decisions. The fact that there are existing investments held for financial return must not prevent the Council from borrowing for **future** **service** investment. Any financial limits included should therefore be flexible enough to allow the Chief Finance Officer to be able to advise the Council to maintain the level of past investments. The Chief Finance Officer should advise the Council on the limits which provide best value for money to the Council.

**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?**

If the purpose is to ensure that it is only revenue sources of finance that appear in the calculation of net revenue stream then we agree to the proposed change.

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

The implementation of the Prudential Code in 2004 was designed to provide local authorities with the ability to manage their own capital strategies in a framework that ensured they were prudent, affordable and sustainable.

The proposed changes to paragraph E17 is of particular concern, especially the last sentence ***“Authorities which have an expected need to borrow should review options for exiting their financial investments for commercial purposes in their annual treasury management or investment strategies***”. Local authorities hold treasury investment in equities, bonds and commercial property funds and commercial property which has been financed from capital receipts or earmarked reserves in the past. These investments are providing a sustainable long term revenue stream. If local authorities have to sell the existing assets and use the capital receipts to fund non-commercial service investment this will keep debt lower – reducing MRP and interest costs - but will lower the income stream from commercial assets **and therefore be detrimental to the provision of local services**. Chief Finance Officers must retain the ability to advice their councils on whether new borrowing or realising investment assets represents the best value for money for their council taking in to account the local circumstances.

It seems inappropriate to penalise those authorities that have a low debt to asset ratio or who are debt free and have scope to prudently manage any increase in debt.

In terms of the practical implementation of the Prudential Code, there will be conflicting legal advice on a local authority’s powers to do something with the content of the Prudential Code. This is likely to put the role of the Chief Finance Officer in direct contradiction with the Council’s Monitoring Officer, undermining the role of the Chief Finance Officer who may be perceived as a blocker to the implementation of Council policy. Each Chief Finance Officer is responsible for understanding the risk and reward of investment proposals. This is articulated in the business cases presented to Members for decision. By making the Code so prescriptive, CIPFA is undermining the professional judgement of Chief Finance Officers.

Councils will be reviewing Capital, Investment and Treasury Management Strategies for 2022/23 in January and February. The consultation on the changes to the Prudential Code does not close until 16 November 2021. By the time CIPFA considers the responses to the consultation and approves the final changes to the Code, there will not be sufficient time for finance teams to encompass the changes within the draft strategies for 2022/23. It is proposed that the changes come in to effect from 2023/24 rather than in 2022/23.

The SDCT hopes that this response will be fully considered before the updated Prudential Code is finalised. The SDCT would be open to further discussion to help make the Prudential Code a useful document that will assist s151 officers in carrying out their duties in the correct manner and provide useful information to Members and the public.

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**10 November 2021**