APPENDIX D

CIPFA Prudential Code for Capital Finance in Local Authorities December 2017 – Revisions

Changes to the Prudential Code

Section	Change type	Details of change
1 – Executive Summary	New Paragraph	Now includes a reference to the Treasury Management Code, as well as reflecting the changes made to the main body of the Prudential Code.
2 – Objectives	New Paragraph	Paragraph added: "The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt." The prohibition that local indicators "should not, unless required to do so by legislation or official guidance, associate any part of the authority's external borrowing with particular item(s), category(ies) or purpose(s) of expenditure" now includes the rider "other than where it relates to a specific funding source or a subsidiary, associate or joint venture."
3 – Scope	New Paragraph	Paragraph added: "The Prudential Code covers all capital expenditure and investment decisions and should take account of all potential long-term liabilities relevant to the authority. For authorities that are required to prepare group accounts or those involved in combined authority arrangements, the consideration of investments and liabilities should include all those in which a residual interest remains with the authority."
4 – Matters Required to be Taken into Account when Setting up or Revising Prudential Indicators	Definition Change	The definition of **affordability** has been amended to "eg implications for long-term resources and ultimately the council tax."
5 – Process and Governance Issues	Various	Sub-section on **governance** discusses how "decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority". It also notes that "local authorities may determine the capital strategy, capital programme and prudential indicators ahead of the revenue budget … provided that explicit reference to the formal decision is made within the revenue budget report."

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		New sub-section gives the **process for determining a capital strategy** “that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.” “The capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.” It should “include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.” The Code states that a capital strategy should cover the following topics: Capital expenditure, including the approval process, long-term financing strategy, asset management, maintenance requirements, planned disposals and funding restrictions. • Debt management, including projections for the level of borrowing, capital financing requirement and liability benchmark, provision for the repayment of debt, the authorised limit and operational boundary for the coming year and the authority’s approach to treasury management. • Commercial activities, including due diligence processes, the authority’s risk appetite, proportionality in respect of overall resources, requirements for independent and expert advice and scrutiny arrangements. • Other long-term liabilities, such as financial guarantees. • Knowledge and skills, including a summary of that available to the authority and its link to the authority’s risk appetite. “In developing the capital strategy a balance should be struck between the amount of detail included and accessibility to the key audience. Where detailed information is required thought should be given to how this is made available, its format and the training needs of members to encourage active engagement. The role of the formal scrutiny process should not be overlooked in ensuring effective challenge. Links should be made where appropriate to the treasury management strategy.

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		The chief finance officer should report explicitly on the affordability and risk associated with the capital strategy and where appropriate have access to specialised advice to enable them to reach their conclusions." The sub-section on **setting prudential indicators** now requires only the indicators for total capital expenditure, operational boundary and authorised limit for to be approved by full council, with the remainder able to be delegated to a committee. New paragraph on **local indicators** has been added: "Authorities should consider whether additional local indicators are needed to reflect local circumstances, including local indicators showing the impact of residual liabilities arising from group structures where relevant. Where appropriate, to improve understanding and relevance, these may be substituted for the relevant indicator set out within this code with the exception of the authorised limit and operational boundary."
6 - Prudence and prudential indicators for prudence	New Paragraph	This section has been expanded to include the **section on capital expenditure, debt and treasury management** from the 2011 Code. New paragraph states that: "The local authority shall ensure that all of its capital expenditure, investments and borrowing decisions are prudent and sustainable. In doing so it will take into account its arrangements for the repayment of debt (including through MRP/loans fund repayments) and consideration of risk and the impact, and potential impact, on the authority's overall fiscal sustainability. While indicators for sustainability are required to be set over a minimum three year rolling period, indicators should be set in line with a capital strategy and asset management plan that is sustainable over the longer term. Where statutorily ringfenced resources such as the HRA or Police Fund exist, the indicators of prudence should be set separately for these areas." The **requirement on prioritising security and liquidity** has been revised: "Authorities should consider a balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield." The statement that "authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed" has been retained in the new Code despite speculation that it would

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		be deleted. The indicator on the adoption of the Treasury Management Code has been deleted.
7 – Affordability and prudential indicators for affordability	New Paragraph	The statement that affordability is ultimately determined by a judgement about acceptable council tax levels has been deleted and replaced by the following three paragraphs: “Affordability should be considered in the light of the authority’s medium-term forecast and other fiscal strategies. Capital expenditure plans should be considered alongside the cost of past borrowing, maintenance requirements and planned disposals. The authority’s MRP/loans fund repayment policy will have a critical impact on the overall affordability of new borrowing and for this reason it is important to look at affordability not just in the medium term but also over the life of the asset base or underlying debt. “Where ringfenced resources or separate funds such as the HRA or Police Fund exist, affordability must be considered against those resources available to fund borrowing. “Under combined authority arrangements affordability may need to be considered against combined authority resources and the impact on underlying authorities. Where debt or guarantees relating to LEPs, subsidiaries or other corporate and non-corporate bodies exist, the impact on the authority should be considered. In these cases the development of local indicators may be appropriate.” Further guidance on **affordability** has also been included: “The authority shall ensure that the revenue implications of capital finance, including financing costs, are properly taken into account within option appraisal processes, the capital programme and the medium-term forecast. In assessing affordability the authority shall consider the council tax implications of its capital programme, borrowing and investment decisions. The local authority shall set and monitor prudential indicators as key indicators of affordability. “It is recognised that indicators of affordability are best determined in the light of local constraints around precepts and ringfenced and statutory funds such as the HRA and Police Fund. Authorities are encouraged to use local indicators that reflect how capital finance is permitted to be financed locally. For example for those authorities with a HRA, the ratio of financing costs to revenue budget

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		should be calculated within the HRA ringfence and an impact on rents calculated. In setting indicators, it should be recognised however that ultimately all debts of a local authority fall on the taxpayer." The prudential indicator is now termed the "proportion of financing costs to net revenue stream" rather than the ratio, but its calculation remains unchanged. The prudential indicator on the incremental impact of capital investment decisions has been deleted.
8 – Definitions	Definition Change	The **definition of an investment** no longer excludes any "that are held clearly and explicitly in the course of the provision, and for the purposes, of operational services". However, since it does not include anything held on the balance sheet under debtors, this will only bring equity investments, and not loans, within the scope of the Prudential Code. Net borrowing is now defined as "borrowing net of treasury management investments".