Practical Implications of the Revised Prudential Code, Treasury Management Code, Local Authority Investments and Minimum Revenue Provision

Executive Portfolio Holder:	*Councillor Peter Seib*
Service Manager	*Paul Fitzgerald, S151 Officer*
Lead Officer:	*Paul Matravers, Finance Specialist*
Contact Details:	*Paul.matravers@southsomerset.gov.uk or (01935) 462275*

Purpose of the Report

1. To update Members on CIPFA's updated version of The Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes (Treasury Management Code) and The Prudential Code for Capital Finance in Local Authorities (Prudential Code) which were published in December 2017.

2. To update Members on revised guidance from the Ministry of Housing, Communities and Local Government (MHCLG) on Local Authority Investments and Minimum Revenue Provision (MRP), published in February 2018 following the consultation in 2017.

3. To summarise the key elements and requirements of the codes and guidance, highlight the changes, identify their implications and to provide an action plan for key actions and decisions that need to be taken in order to comply with the updated requirements.

Recommendation

4. Audit Committee notes the implications and actions required arising from new Codes of Practice and Statutory Guidance which includes:

   Prudential Code (2017)
   Treasury Management Code (2017)
   Statutory Guidance on Local Authority Investments (2018)
   Statutory Guidance on Minimum Revenue Provision (2018)

Background

5. The Chartered Institute of Public Finance and Accountancy (CIPFA) and central Government recognise that local authorities are undertaking a range of measures to respond to austerity impact on local government funding, including adopting updated or new strategies in respect of treasury and commercial investments. Such measures result on authorities changing attitudes and appetite for risk, and venturing into new areas. In this context, both CIPFA and Government consulted during 2017 on proposed changes to relevant codes of practice and statutory guidance.

6. Like other authorities, South Somerset has taken such measures with the Council approving a new commercial strategy in August 2017 and updated financial strategy in September 2017. It is important that SSDC therefore understands the updated requirements and ensures its governance and business processes are reviewed accordingly.

7. The new Codes and Guidance are by their nature quite technical and use terminology that is used in practice by Council staff who specialise in these areas. This report includes a lot of detail in the appendices that aims to highlight the key requirements, which by definition uses related jargon. Please contact the Lead Officer for this report if any clarification is required.

Prudential Code and Treasury Management Code of Practice

8. As referred above, in 2017 CIPFA consulted on proposed changes, and in December 2017 published updated editions of the:

- The Prudential Code for Capital Finance in Local Authorities (Prudential Code)
- Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes (Treasury Management Code)

9. Appendix A to this report focuses on the detailed practical implications of the new publications, however a summary of the major changes are provided below.

   a. **Capital Strategy** – The Prudential Code includes a requirement to produce a Capital Strategy which provides a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services, and a long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability.

   b. **Prudence and Prudential Indicators** – 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 range of Prudential Indicators has been updated including deletions and a recommendation of potential indicators to include in the Capital Strategy.

   c. **Treasury Management Practices (TMPs)** – TMPs set out the operational procedures and 'rules' followed by its treasury management staff in managing day to day decisions in respect of the council's banking, investment and borrowing arrangements. The updated Codes bring recommended wording change for TMPs.

   d. **Management Practices for Non-Treasury Investments** – New requirement for management practices (similar to TMPs) to be developed and implemented for non-treasury investments (such as commercial investment properties) – providing clearly documented procedures for our approach to commercial investment such as the scope of due diligence to be completed. In practice this is covered in our existing governance arrangements but these will be reviewed to provide further assurance.

   e. **Definition of investments** –, the definition of 'investments' has been widened to include not only financial assets (e.g. cash placed in Money Market Funds) but also non-financial assets held primarily for financial returns such as investment property.

Investment Guidance

10. In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Statutory Guidance on Local Government Investments and Statutory Guidance on Minimum Revenue Provision (MRP).

11. Below are the main changes included in the revised Local Government Investments guidance, further details are included in Appendix B:

a. **Definition of investments** – Includes a wider definition of investments to include non-financial assets held primarily for generating income return.

b. **Loans –** A new category of investment called "loans" (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate) has been introduced within the scope of the Guidance. This will be relevant if the Council provides loan finance to third parties.

c. **Definition of Borrowing In Advance of Need –** Under the Guidance, MHCLG have emphasised that councils may not "borrow in advance of need" to profit from the investment of the sums borrowed. This is not new in the context of treasury investments. What is new is that this will apply to non-financial investments (e.g. investment in commercial property that is solely commercial). Under legislation, local authorities must "have regard to" the statutory guidance, and where authorities chose to disregard this guidance they must explain the reason(s) why including purposes for investing the money borrowed and management of risks.

   This is a key consideration for SSDC as the Council has agreed its Commercial Strategy which will reply on the use of borrowing powers to acquire assets for commercial return. The Commercial Strategy provides clarity on the reasons for the commercial investment and why it is needed to protect local services for our community. Importantly the new Guidance does not prohibit SSDC from borrowing, however we will need to reinforce our governance and reporting to ensure the reasons for disregarding the Guidance is open and transparent.

d. **Introduces the concept of proportionality –** the extent to which expenditure to meet the service delivery objectives and/or place making role of that local authority is dependent on profit-generating investment. The guidance also proposes additional reporting requirements where the Council borrows to invest and also specifies additional indicators.

e. **Reliance on Investment Income –** Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

12. The main purpose of the updated guidance is to ensure local authorities are taking investment decisions with a good understanding of the risks, clear plans in place to manage risks, and a clear understanding the relative reliance on investment income in meeting its purpose and priorities. It strengthens the requirement for open and transparent reporting whilst recognising this needs to be balanced to protect the Council's commercial position.

Managing Debt Repayment

13. In its simplest form, "MRP" is the amount a local authority should charge to the budget each year to repay capital borrowing. The main changes to the statutory guidance on Minimum Revenue Provision (MRP) issued in February 2018 (applicable from 2019/20 financial year), with additional information also included in Appendix B, are:

    a. The definition of 'Prudent MRP' – a revised definition is included in the guidance is 'to put aside revenue over time to cover the Capital Financing Requirement (CFR).' In other words we need to make sure we are budget for the repayment of capital borrowing on a prudent basis.

b. The suggested methods for calculating the provision for debt repayment have been updated, for example to propose that (subject to certain conditions) the repayment period for capital debt should not exceed 50 years.

c. Due to timing of the publication there is no requirement to reflect the revised guidance in the approved 2018/19 investment strategy and MRP policy; however the new guidance is applicable from the 2019/20 financial year.

14. Authorities can continue to choose their own method(s) for calculating MRP and will need to ensure this can be justified as prudent – for example – with our external auditor.

15. The changes to the Treasury Management Code of practice and the Prudential Code for Capital Finance are detailed in Appendix C and D respectively for information.

Financial Implications

16. There are no immediate direct financial implications in respect of this report.

17. The new investment guidance could have an impact on the Council's financial strategy – and Commercial Strategy in particular – if these were amended to strictly apply the definition of "borrowing in advance of need". In response to the Government's consultation we were clear that in our view the definition of "need" is very different in the current funding landscape for local authorities, where we have much reduced availability and reliance on government grant funding, and greater reliance on a combination of local taxation and addition income generation through commercial investment activity. The Council needs to generate income through commercial investment in order to fund and protect services. There is some flexibility to use reserves to support some investment costs however the majority of commercial investment will require upfront borrowing. Appropriate due diligence is undertaken to identify and manage risks, and the commercial strategy clearly explains how the commercial income will support the Council's priorities. It is recognised this will need to be reviewed and possibly updated, and it is a positive step to ensure this is regularly and openly reported to Members and other stakeholders through the new Capital Strategy.

18. The application of the new Codes and Guidance will be incorporated within the financial framework of the Council including the treasury and investment strategies, capital strategy and budget strategy. A summary of the proposed key actions in response to the new Codes and Guidance is shown in the table below:

<u>Action Plan</u>

	Action	Responsible	Target Date
1	Treasury Management Practices to be reviewed and updated ensuring compliance with the new Codes, to be approved by the S151 Officer	Finance Specialist	Sep 2018
2	Prepare new Management Practices for non-Treasury Investments, to be approved by the S151 Officer	Finance Lead Specialist	Sep 2018
3	Prepare a new Capital Strategy, to be updated annually alongside the Budget and Treasury Strategy, incorporating relevant quantitative indicators that allow Councillors and the public to assess the Council's total risk exposure as a result	S151 Officer	Feb 2019

	of its investment decisions		
4	Review Commercial Strategy and related governance and reporting, including terms of reference and decision reporting process of the Investment Assessment Group (IAG), to ensure compliance with new Codes and Guidance	Director Commercial Services and S151 Officer	Oct 2018
5	Ensure the 2019/20 Treasury Strategy meets the requirements of the new Codes and Guidance	S151 Officer	Feb 2019
6	Review and update the Council's MRP Policy for approval ready for 2019/20 financial year	S151 Officer	Feb 2019
7	Review Financial Regulations and update to reflect requirements of new Codes and Guidance as required	S151 Officer	Oct 2018
8	Ensure budget setting and monitoring reports complement the reporting requirements of the Capital Strategy and provide open and transparent information on the reliance and impact of treasury and commercial investments.	Finance Lead Specialist	Feb 2019

Background Papers
None