

Prudential Code Update

David Ellis FCPFA
Advisor, CIPFA Finance Advisory Network

The Chartered Institute of
Public Finance & Accountancy

1

NAO Report – Local Authority Investment in Commercial Property (February 2020) – Recommendations for MHCLG

- Need to improve quality of commercial activity data to better understand risks and provide compliance assurance
- Need to articulate nature and scale of behaviour causing concern and actively monitor trends with flexible intervention where required
- Review prudential framework, MHCLG oversight and intervention arrangements to ensure fit for purpose
- Assess impact of changes to codes and guidance on behaviour

2

NAO Report – Some Key Facts

- £6.6bn estimated LA spend on commercial property from 2016-17 to 2018-19
- 49 out of 352 local authorities accounted for 80% of commercial property spending
- 28.7% real-terms reduction in local authorities' spending power (government funding and council tax) from 2010-11 to 2019-20
- 14.4 times more spend on commercial property acquisitions by local authorities in 2016-17 to 2018-19 compared with preceding three years
- 38.0% of local authorities' commercial property acquisitions by value in the period 2016-17 to 2018-19 were outside their boundary

<https://www.nao.org.uk/report/local-authority-investment-in-commercial-property/>

Copyright © CIPFA 2021 protected under UK and international law

3

3

Commercial property purchases by English local authorities, 2010-11 to 2018-19

Spend on acquisitions has increased significantly in the period 2016-17 to 2018-19



Source: <https://www.nao.org.uk/wp-content/uploads/2020/02/Local-authority-investment-in-commercial-property.pdf>

4

4

PAC Report - Local Authority Investment in Commercial Property (July 2020) – Main Recommendations for MHCLG

- More active oversight of prudential framework and communicate publicly the types and scale of commercial activity where it has concerns - and challenge such behaviour
- Develop and deploy interventions that target extreme risk taking
- Undertake review of MRP guidance and consider whether statutory basis should be strengthened and how to improve clarity and transparency of LA commercial property reporting
- Undertake thorough review of prudential framework – publicly reporting within 12 months
- Set out response to Redmond Review on how to strengthen local audit and governance of commercial investment activity
- Set clear expectations about investment details required in capital strategies

<https://publications.parliament.uk/pa/cm5801/cmselect/cmpublicacc/312/31202.htm>

PWLB Consultation (11 March – 31 July 2020) and Revised Lending Terms

- HM Treasury consulted on proposals for future lending terms including one-year ban if borrowing to fund commercial property investment
- CIPFA's response
 - Compliance with Prudential Code to be statutory requirement
 - Support overall spirit to curtail borrowing for investment in risky, profit-making ventures but revisions must be proportionate, fit for purpose, and remain principles-based
 - Terms must not impede an authority's ability to undertake vital role in society - affordable refinancing facilities will be essential
- Consultation outcome published alongside Spending Review – Circular 162 effective immediately – preventing PWLB borrowing where plans to buy investment assets primarily for yield
- <https://www.dmo.gov.uk/media/17135/circular-162.pdf>

Prudential Property Investment Guidance (2019)



<https://www.cipfa.org/policy-and-guidance/publications/p/prudential-property-investment>

Copyright © CIPFA 2021 protected under UK and international law

7

7

Prudential Property Investment Guidance (2019)

- Reflects circumstances where there is no specific or projected need to borrow but an opportunity has been identified to make an investment return greater than the authority's cost of borrowing
- Local authorities can borrow at relatively low rates, so there are often tempting opportunities to generate income at no net capital or revenue cost - however, this is not a risk-free activity
- Guidance asks three questions
 - Can We Acquire Commercial Property?
 - Should We Acquire Commercial Property?
 - Will We Acquire Commercial Property?

Copyright © CIPFA 2021 protected under UK and international law

8

8

Prudential Framework – Next Steps

- MHCLG to review data requirements and CIPFA to review Prudential / TM Codes
- CIPFA's intention is to strengthen and modernise the Codes while maintaining the integrity and spirit of the Codes within existing permissive framework
- Consultation early 2021 (10 weeks)
- Publication of revised Codes anticipated late 2021 or early 2022
- Fundamental review will include consideration of governance arrangements and prudential indicators
- Please respond to the consultation!

Objectives of the Prudential Code

Prudential Code Framework should support

- local strategic planning
- local asset management planning and proper option appraisal

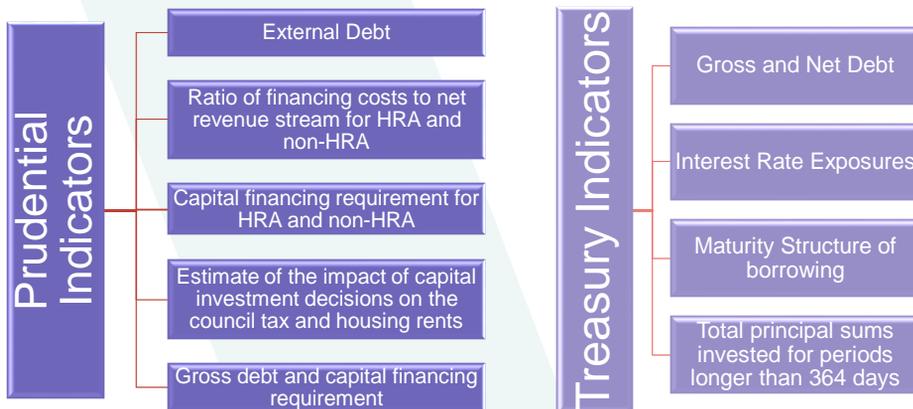
The objectives of the Prudential Code are to ensure:

- that capital expenditure plans of local authorities are affordable, prudent and sustainable, and
- treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation

What could change in the Codes?

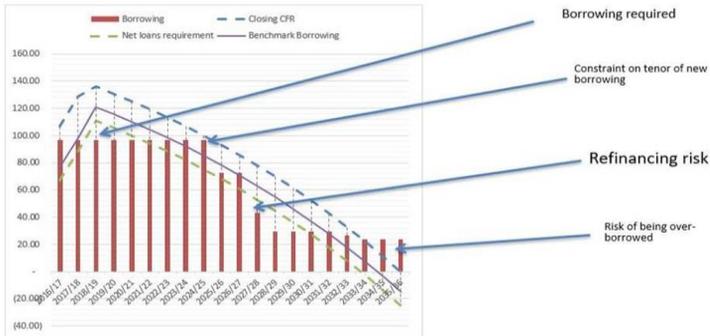


Prudential and Treasury Indicators



Introduction of Liability Benchmark

LIABILITY BENCHMARKING: EXAMPLE



Copyright © CIPFA 2021 protected under UK and international law

13

13

- Introduction as Prudential Indicator
- Key tool for managing risk
- Long term sustainability

Governance

- Code based on self regulation
- Requirement to nominate committee responsible for overseeing Treasury Function
- Is this sufficient?
- Knowledge and skills?
- Cycle of reports
- Information in strategy

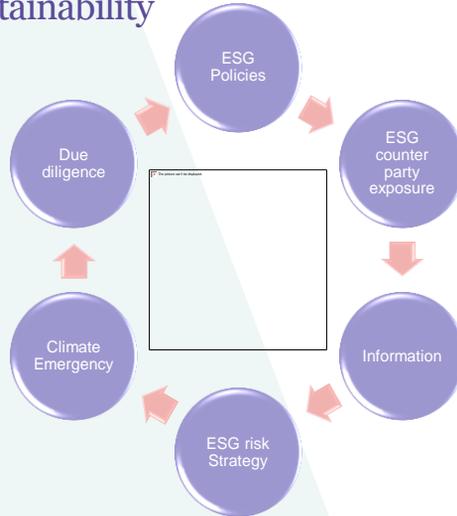


Copyright © CIPFA 2021 protected under UK and international law

14

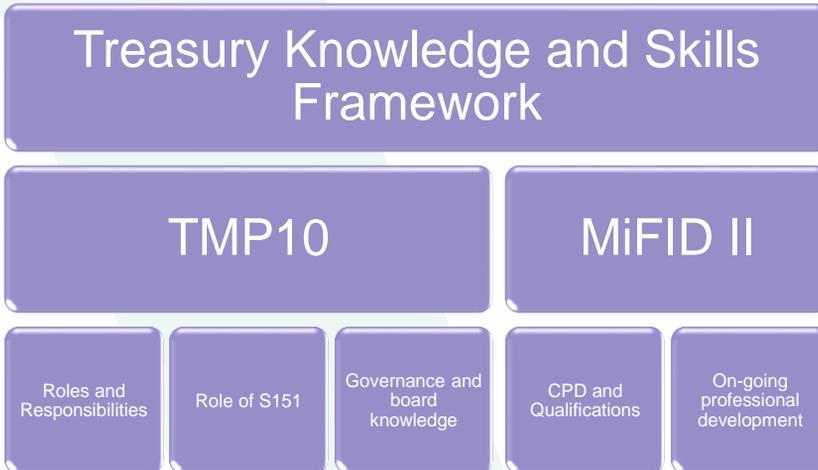
14

ESG Factors and Sustainability



Copyright © CIPFA 2021 protected under UK and international law

Knowledge and Skills



Copyright © CIPFA 2021 protected under UK and international law

CIPFA\

Taking Action...

The Chartered Institute of
Public Finance & Accountancy

17

CIPFA\

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Unless otherwise stated copyright in the whole and every part of the information belongs to CIPFA, and may not be used, sold, licensed, copied or reproduced in whole or in part in any manner or form or in any media to any person without **written consent**. Although care has been taken to ensure the content accurate and timely, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. CIPFA therefore accepts no liability for loss of any kind incurred as a result of reliance on the information or opinions provided in this presentation. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The Chartered Institute of
Public Finance & Accountancy

18