Report of the Service Director – Finance

AUDIT AND GOVERNANCE COMMITTEE – 28th JULY 2021

CIPFA CONSULTATION ON THE PRUDENTIAL AND TREASURY MANAGEMENT CODES

1. Purpose of the Report

1.1 This report presents the proposals on the CIPFA Prudential Code and the CIPFA Treasury Management Code changes following recent CIPFA Consultations on both Codes.

2. Recommendations

2.1 It is recommended that the Committee note the issues arising from the CIPFA consultations and endorse the Council's approach to the proposed changes and how these will be addressed by Treasury Management officers.

3. Background Information

3.1 CIPFA released two separate consultations on Treasury Management related activities with a closing date of the 12 April 2021.

The two consultations were on the Prudential Code and the Treasury Management Code and although the objectives are different, there is some overlap between the two consultations. The requirement to put in place a holistic training plan (included in the Treasury Management Code) is particularly pertinent to the members of the Audit Committee.

CIPFA has published their response to the consultations on 24th June 2021 and outlined the changes that will be taken forward and incorporated within the revised Codes that are due to be published in December 2021. CIPFA expects Local Authorities to apply 'principles' from the publication date and implement a full adoption from 1st April 2022, and the purpose of this report is to outline the main issues arising from the consultations and also prepare the Council / Audit Committee for any changes, particularly in relation to member training requirements.

The details of each consultation are provided separately below.

4. The Treasury Management Code

4.1 The purpose of this consultation is primarily to:

- ensure that both officers and members are appropriately trained on treasury management;

- consider the addition of a new Treasury Management Practice to address environmental, social and governance risks;

- ensure appropriate resource is dedicated to the review and scrutiny of treasury management decisions (i.e. a dedicated committee);

- consider a requirement for the maturity structure of borrowing treasury management indicators on the introduction of the liability benchmark indicator.

4.2 The consultation seeks to ensure all authorities have a training plan in place which covers all those involved in Treasury Management from the in depth knowledge required by the officers that make up the treasury team to the overview knowledge required by SMT and Member forums. Training should therefore be rolled out on a tailored basis to reflect an individual's level of Treasury Management involvement.

A similar training requirement was introduced in the period after the 2008 financial crash. This training focused on the risks involved in Treasury Management such as investment default which occurred when the Icelandic banks collapsed. As a result of the proposals, CIPFA also facilitated some additional training for officers and members including a bespoke qualification for those most involved in Treasury Management. A similar training programme will be provided this time around when the framework is finalised and incorporated into the Training Plan.

To a large extent, the Council has maintained the good training practice it introduced in the wake of the 2008 crash even though it was not one of the authorities directly impacted by the Icelandic bank collapse. For example, the treasury team continues to receive regular training updates from our advisers, Link, the team / advisers also continue to provide Treasury Management training to a number of Member forums and lastly, a Treasury Management Panel has been maintained which includes the two Core Services Cabinet spokespersons.

However, there are one or two gaps in our good practice that we will seek to rectify. For example, CIPFA discontinued its bespoke Treasury Management qualifications a number of years ago and therefore no new members of the team have been offered formal qualifications in Treasury Management. Equally, the Audit Committee initially decided to allocate two of its members as Treasury Management spokespersons on the basis that this is a very technical area but this has lapsed over time. Audit Committee might want to consider whether to re-adopt this practice in future as a result of this latest consultation / update.

As outlined in their response, CIPFA will proceed with the implementation of the Treasury Management Knowledge and Skills framework. CIPFA will add a level of 'scalability' or maturity to ensure flexibility for small to large organisations of various complexity and resources. CIPFA recognises that certain roles will be fulfilled as part of a job at smaller organisations. However, the purpose of the schedule is to not only recognise the professional role and importance that treasury managers play within their organisation but also to highlight the need for resources and training where appropriate. CIPFA will also provide a template for organisations to produce a 'learning needs analysis' to support the implementation of new requirements and processes under the expanded guidance.

Officers plan to undertake 'learning needs analysis' using CIPFA's template when it becomes available, and a training plan will be developed including training requirements for officers, Councillors and members of the Audit Committee. It is anticipated that training will be delivered internally by the Treasury Management officers and externally by our Treasury Management advisers.

4.3 In addition, CIPFA proposed to add a new Treasury Management Practice to address environmental, social and governance risks.

CIPFA recognised the arguments put forward by the respondents and will not at this juncture include a separate TMP for ESG risks. However, they will incorporate ESG issues as a consideration within TMP1 (Risk Management). This would place ESG alongside the other risks facing local authority treasury management, rather than potentially being seen to give it precedence. This will ensure robust due diligence procedures are designed, implemented and monitored to the same professional level subject to the relevant treasury activity for each individual authority.

The Council will consider ESG requirements as part of the Treasury Management Investment Strategy and provide an update as part of quarterly reporting.

4.4 The proposed changes also included a requirement for a dedicated committee that would deal with more complex treasury management functions (i.e. a professional client under MiFID II legislation).

However, CIPFA recognised the consistent theme within the responses disagreeing with these proposals, and will revisit the proposals to make sure that they take on board the views of respondents while ensuring that appropriate resource is dedicated to the review and scrutiny of treasury management decisions.

To a large extent, our existing Treasury Management Panel would cover this requirement.

4.5 Finally, CIPFA proposed to remove the maturity structure of borrowing treasury management indicators on the introduction of the liability benchmark indicator.

In their response, CIPFA stated that they will not remove the maturity structure indicator. However, if the organisation is publishing a liability benchmark then it will consider approaches to make this indicator optional.

The Council will continue using the maturity structure of borrowing treasury management indicators, it is a useful tool that helps to plan any new borrowing and control any excessive loan maturity spikes in the external loan portfolio.

5. The Prudential Code

5.1 The primary objectives of this consultation are to:

- prevent Local Authorities using borrowing primarily for yield;

- consider adding proportionality as an objective in the Prudential Code, as well as adding further provisions so that an authority incorporates an assessment of risk to levels of resources;

- define commercial activity and investment, and ensure that the purchase of commercial property purely for profit cannot lead to an increase in the capital financing requirement (CFR);

- consider the addition of the new indicators for net income from commercial and service investments to net revenue stream to assess proportionality;

- introduce the liability benchmark as a treasury management indicator.

5.2 The proposed changes to the CIPFA Prudential Code seek to address the issue of borrowing purely for yield. Without the strengthened provisions, local authorities risk further government intervention in the Prudential Framework.

The Government have been concerned about this issue for a number of years largely in relation to a small number of authorities that have been borrowing to invest in 'out of borough activities / infrastructure / commercial property' (i.e. hotels) purely to generate a return.

Following a review of responses CIPFA have confirmed that the Prudential Code will be revised to include the proposed clarifications that are intended to protect the public purse and avoid misinterpretation of the Prudential Code's provisions. This will help to make clear that an authority must not borrow to invest primarily for the purpose of commercial return.

The proposals are consistent with the new guidance on Public Works Loan Board (PWLB) borrowing published in November 2020. The UK Government's rules for access to PWLB lending require statutory Chief Finance Officers to certify that their local authority's capital spending plans do not include the acquisition of assets primarily for yield. This reflects a view that local authorities' borrowing powers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management rather than to add gearing to return-seeking investment activity.

The Council has no intentions to borrow to finance acquisitions where obtaining commercial returns is the primary aim.

5.3 Following the positive response to the proposals in the consultation paper, CIPFA will include proportionality as an objective in the Prudential Code, as well as further provisions so that an authority incorporates an assessment of risk to levels of resources.

On the matter of commercial proportionality, CIPFA have, however, recognised that commercial activity is often a component of successful regeneration projects. They therefore propose that local authorities assess the proportionality of the commercial risk of all projects, including regeneration, to quantify the risk to their resources. As a simple example, if a local authority has reserves of £20m and carries commercial risk of £50m, this would be considered disproportionate.

Treasury officers will review the guidance to ensure compliance with the proposed changes.

5.4 CIPFA will provide clarification and definitions to define commercial activity and investment. The amendments to the Prudential Code will be consistent with the proposals outlined in Section 5.2 of this report, that the purchase of commercial property purely for profit cannot lead to an increase in CFR but also provide clear guidance that an economic regeneration scheme that has clear policy objectives, part of which results in commercial income, is considered acceptable.

As stated earlier in this report, the Council has not and will not borrow to finance acquisitions where obtaining commercial returns is the primary aim.

5.5 CIPFA proposals also included the addition of the new indicators for net income from commercial and service investments to net revenue stream to assess proportionality.

CIPFA confirmed that it will implement the new indicator, with the addition of comparing this to levels of reserves to provide context on the financial sustainability of a local authority. Further to this, a narrative should be provided on the security of the commercial income to assess the levels of risk attributed to commercial revenue.

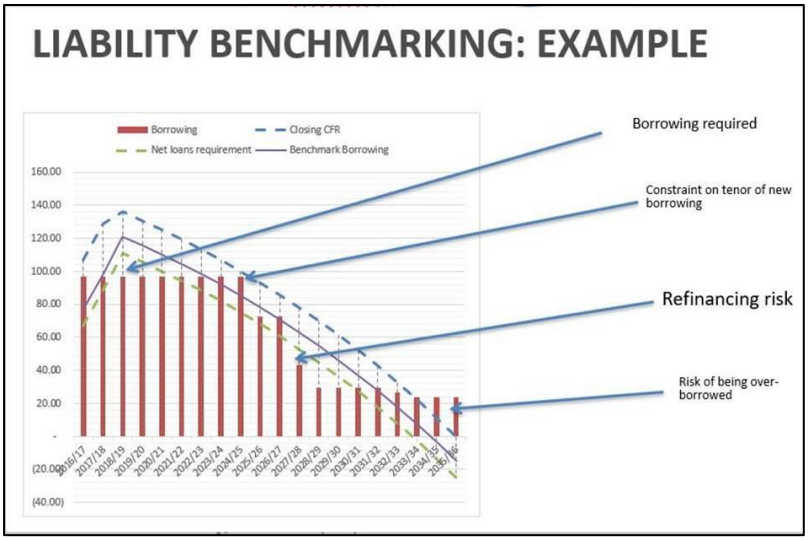
Treasury officers will review the guidance and develop the net income from commercial and service investments to net revenue stream indicator in line with the revised Prudential Code requirements.

5.6 CIPFA will implement the liability benchmark as a treasury indicator and will provide substantial guidance on the use and creation of a liability benchmark to enable local authorities and other organisations to use this effectively.

CIPFA explained that the liability benchmark is an essential risk management tool. The optimum position is for total borrowing to be on the liability benchmark line. Borrowing above that level will be reflected in increased investment balances and introduce the cost of carry and additional credit risk implications, although this may be needed to anticipate interest rate movements and secure affordable borrowing.

The new tool will help to measure borrowing levels and the profile of debt over time. This indicator is based on future cash flows and forecast minimum revenue provision (MRP) for repayment of debt in the future. If debt exceeds the liability benchmark the authority has a cash surplus and is holding on deposit. It is a measure of an authority's existing (and committed) loans portfolio that is compared with its forecast loan needs. This benchmark should enable the authority to understand and manage its exposure to treasury risks. Using the benchmark maturity profile or net loans benchmark enables the authority to minimise its treasury risks by matching its maturity profile to the liability benchmark.

CIPFA have provided a graph to illustrate how they expect the liability benchmark to work. This is shown below.



The Council's Treasury Management strategy and quarterly updates already include some of these measures i.e. maturity profile, fixed rate borrowing, capital financing requirement, although these measures provide a medium-term outlook. CIPFA recommends that the liability benchmark is produced for at least 10 years and should ideally cover the debt profile of a local authority.

Treasury officers will review the detailed guidance and develop the liability benchmark indicator in line with the revised Prudential Code requirements.

5.7 Other less significant changes proposed by CIPFA (including proposals that CIPFA is not planning to take forward) are outlined below:

- CIPFA propose to add sustainability as a criteria and ensure that capital expenditure is consistent with a local authority's corporate objectives (such as diversity and innovation) to the objectives in the Prudential Code. CIPFA believes sustainability is an important

issue and will provide additional direction to support sustainable behaviour in the guidance without prescription;

- CIPFA asked authorities to consider if the current objectives of the Prudential Code are still relevant. The sector continues to view the Prudential Code as relevant, professional and an objective framework designed to ensure capital plans are prudent;
- CIPFA asked authorities to consider if the provisions in the Prudential Code achieve current objectives. CIPFA recognises that elements of the Prudential Code may require further definition and clarification, and the CIPFA secretariat would welcome views on how the objectives might be updated;
- CIPFA asked to consider if there are any areas that are not fully covered by these objectives. CIPFA will review the proposals and consider how the Prudential Code might be updated. The CIPFA secretariat would seek the views of the CIPFA panel on how this might be undertaken;
- CIPFA proposed to include the status of the Prudential Code within the body of the code itself and will implement this proposal;
- CIPFA proposed to include additional commentary on the assessment of affordability and the details of risks of undertaking commercial activity within the commercial activities section on determining the capital strategy. As covered in previous responses, CIPFA will provide clarification on the definitions of investments primarily for yield and those related to regeneration activities within the final Prudential Code and guidance;
- CIPFA asked to provide suggestions on how the prudential indicators could be improved in order that they might provide additional assurance for public accountability. CIPFA will consider responses and would welcome any further comments from the CIPFA panel on the proposals and how the Prudential Code and its guidance might be updated;
- CIPFA proposed the addition of the new indicator for external debt to net revenue stream to assess proportionality. CIPFA will not implement this proposal, but it will recommend in guidance that local authorities consider introducing this or similar indicators as local indicators. The CIPFA panel's views are sought on this issue;
- CIPFA suggested the removal of the prudential indicator - gross debt and the CFR on the basis that it is included as part of the liability benchmark, which is to be introduced as a prudential indicator. Based on responses provided, CIPFA decided not to remove the prudential indicator on gross debt and CFR.

6. Financial Implications

6.1 Any financial implications of the changes are incorporated in the body of the report.

7. List of Appendices

7.1 CIPFA Consultation response – Treasury Management Code
7.2 CIPFA Consultation response – Prudential Code
7.3 CIPFA Prudential and Treasury Management Code consultation outcome - summary for clients provided by Link Group (the Council's Treasury Advisors)

Report Author: Service Director – Finance
Email: neilcopley@barnsley.gov.uk
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