Manchester City Council
Report for Information

Report To: Audit Committee – 26 July 2022

Subject: Prudential Framework Changes

Report of: Deputy Chief Executive and City Treasurer

Purpose

To report on revised CIPFA Prudential and Treasury Management Codes of Practice.

Recommendations

The Audit Committee is asked to note the contents of the report

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Wards Affected: Not Applicable

Environmental Impact Assessment - the impact of the issues addressed in this report on achieving the zero-carbon target for the city
None

Equality, Diversity, and Inclusion - the impact of the issues addressed in this report in meeting our Public Sector Equality Duty and broader equality commitments
None

Manchester Strategy outcomes	**Summary of how this report aligns to the OMS/Contribution to the Strategy**
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	
A highly skilled city: world class and home-grown talent sustaining the city's economic success	
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	
A liveable and low carbon city: a destination of choice to live, visit, work	
A connected city: world class infrastructure and connectivity to drive growth	

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences

Revenue – None

Capital – None

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

Treasury Management Strategy Statement 2021/22, including Borrowing Limits and Annual Investment Strategy (Executive – 16th February 2022, Resource and Governance Scrutiny Committee – 28th February 2022, Council – 4th March 2022)

1 Introduction and Background

1.1 Capital finance and treasury management in local government is regulated by the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance and the Code of Practice on Treasury Management in Local Authorities (the Codes). The Codes form the prudential finance framework within which local authorities should manage the financial risks associated with capital investment, treasury investment, and borrowing.

1.2 Treasury Management in this context is defined as:

‘*The management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks*’.

1.3 There has been increased scrutiny of local authority ‘commercial activity’ since concerns were first flagged by the Public Accounts Committee in November 2016. The NAO report ‘Local Authority Investment in Commercial Property’ published in 2020 raised questions about the extent to which DHCLUC and HMT could rely on the Prudential Framework in its then form, to support value-for-money decision making in the current legal and financial context – the scale of investment of public funds in this activity from 2017, the concentration of this activity in a relatively small group of authorities, and the use of borrowing to finance such investments was described by the NAO as ‘striking’ with a need for this to be considered alongside potential financial sustainability and value for money.

1.4 Since inception, CIPFA have revised the Codes on a number of occasions, to ensure that the regulations reflect current market conditions and concerns. Further revisions have now been made in the light of the above concerns.

2 Context

2.1 As noted in the interim treasury management report to Audit Committee in November 2021, CIPFA have consulted with local authorities on changes to both the Prudential Code and the Treasury Management Code.

2.2 The Codes form part of the prudential borrowing risk management framework for local authorities, alongside guidance on investments and minimum revenue provision (MRP) issued by DLUHC, and Public Works Loan Board (PWLB) borrowing guidance.

2.3 The consultations followed changes to the borrowing rules from the PWLB that reflected Government concerns about local authorities borrowing funds to invest in assets solely for the return generated, rather than for service delivery. The intention of the consultations was to reinforce the risks associated with “for yield” investments, and to provide members and the public with more information about the scale of commercial investments that an authority may hold.

3 Revised CIPFA Prudential and Treasury Management Codes of Practice

3.1 The revised codes were published in late 2021 and contain a number of significant changes which the Council will need to implement in time for the Treasury Management Strategy Statement for 2023/24, and which will therefore form part of the budget presented to members in early 2023. The main changes in the code are described below.

3.2 The Prudential Code closely aligns to the recent changes in PWLB lending conditions and reinforces that local authorities must not borrow to invest primarily for financial return. In doing so, it introduces requirements around proportionality, alongside the existing Code objectives of affordability and prudence.

3.3 The Code identifies three different investment types, all of which would need to be covered with an authority's Capital and Treasury Management strategies:

- Investments for treasury management purposes;
- Investments for service purposes; and
- Investment for commercial purposes, which would include commercial property.

3.4 Creating this distinction then allows for the creation of a further prudential indicator, namely net income from commercial and service investments to the Council's net revenue stream, to show the net financial impact on the authority of all non-treasury investments. Introducing this indicator also provides an indicator of the proportionality of non-treasury investments in comparison to the Council's overall net revenue income.

3.5 The Treasury Management Code similarly reflects the three identified investment types and requires authorities to include all investments, including non-treasury, in public reports on treasury management, and set investment strategies for each.

3.6 Within the Treasury Management Code there are two other significant changes. The first is a more formal requirement to include a "liability benchmark" within an authority's prudential indicators. The liability benchmark is intended to show, based on the existing approved capital and revenue commitments and the known debt obligations on an authority's balance sheet, the forecast net debt position over at least the next 10 years, but preferably longer. This should then inform decision making on further debt drawdowns, with the intention that any mismatches between future debt outstanding and the liability benchmark would be explained as part of the Capital or Treasury Management Strategies.

3.7 The Capital Strategy that formed part of the 2022/23 budget contained a version of the liability benchmark, shown at appendix A, and this will be reviewed to ensure it meets the requirements of the revised Code.

3.8 The second change relates to a strengthening of the requirements for training and qualifications. This includes the need to review the skills and knowledge of all staff involved within the treasury management function, and creates a requirement that the responsible officer, in the Council's case the Section 151 officer, must ensure that council members tasked with treasury management responsibilities, including scrutiny, have access to training relevant to their needs and responsibilities.

3.9 The changes required by both Codes are to be implemented by 2023/24, and so will form part of the next Capital and Treasury Management Strategies, which will form part of the budget in early 2023.

3.10 In the interim, it is proposed to provide training to members, including members of Audit Committee and Resources and Governance Scrutiny Committee as the two committees tasked with scrutinising the strategy and activity of the treasury management function, ahead of the next budget cycle and alongside the interim treasury management report for 2022/23.

4 Implications for the City Council

4.1 Within the Capital Strategy included in the budget papers to Executive in February it is clearly stated that the Council will not invest in capital schemes purely for yield. All investment decisions align to strategic priorities and are within the local authority boundaries (the only exception will potentially be for solar energy where there is a different economic footprint). The same report notes that the Council does have assets of a commercial nature on the balance sheet. These include long-term debtors, investments and investment properties.

4.2 All of the Council's historic long term debtors and investments have been made in line with strategic priorities and to support regeneration as opposed to being purely for yield. The debtors include loan finance provided to Manchester Airport Group, Manchester College and PFI prepayment. The investments are equity investments held including Manchester Airport, Destination Manchester which is the Council's investment in Manchester Central, Manchester Science Park and Matrix Homes. Investments are valued on an annual basis.

4.3 The balance sheet does include £468.5m of investment property. This investment is in property held solely to earn rentals and/or for capital appreciation. For the Council this includes land held for regeneration purposes and land held at Manchester Airport. Properties are held for regeneration purposes but as they provide a return they have to be shown as investment property. Investment properties are independently valued on an annual basis.

4.4 The revised Codes have a relatively strict definition of net income relating to service and commercial investments, and so work will be undertaken during the year to correctly identify the accepted income and costs to be included in this calculation.

4.5 As noted above, the Council currently includes a version of the liability benchmark within the Capital Strategy, and this will be reviewed to ensure it is compliant with the Code, and to include a stronger explanation within the Strategy of what it is and how it should be viewed.

4.6 There are no particular concerns arising from the changes to the Prudential Code and other guidance as the Council has not pursued a strategy of commercial investment for yield to support the revenue budget. However, it does reinforce the need for strong governance and careful due diligence in all investment decisions. As resources tighten, affordability of prudential borrowing to support priorities will also be an issue.

5 Other Changes

Levelling Up and Regeneration Bill

5.1 In the Levelling Up and Regeneration Bill, published by Government in May, the Secretary of State would be given powers to issue a "risk mitigation" direction should a local authority issue a Section 114 notice, receive exceptional funding from Government or a capitalisation directive, or breach one of five "capital risk thresholds".

5.2 The five thresholds are:

- The total of a local authority's debt compared to the financial resources of the authority;
- The proportion of the total of a local authority's capital assets which are held wholly or mainly to generate financial return;
- The proportion of the total of a local authority's debt where the counterparty is not central government or another local authority;
- The amount of minimum revenue provision charged by a local authority to a revenue account in a financial year; and
- Any other metric specified by regulations made by the Secretary of State.

5.3 The risk mitigation directive could be either a limit in relation to the borrowing of money by the local authority, or a directive to the authority requiring it to act in a specific way. The intention of the Bill is to give the Secretary of State greater powers to intervene with local authorities that give cause for concern within the prudential framework.

Changes to PWLB borrowing guidance

5.4 The PWLB have also published changes to the guidance for applicants, further to the changes in borrowing conditions previously reported to members. The key change is that the Board will not advance funds to a local authority if it considers that there is more than a negligible risk of non-repayment. This risk could be assessed through the five risk thresholds noted above.

5.5 This is a significant change within the Prudential Framework, as traditionally the PWLB has been considered the lender of last resort for local authorities.

Minimum Revenue Provision changes

5.6 The Government is also currently consulting on changes to how minimum revenue provision (MRP) should be calculated. When a local authority borrows to fund a capital scheme, it is required to make an annual prudent provision towards the repayment of the debt. Guidance is published by the Government on the various calculation options.

5.7 It is for individual local authorities to decide what is a prudent provision and, for some, where capital loans have been provided to third parties, no MRP has been made as they anticipate that the loan will be fully repaid.

5.8 The consultation seeks to address this issue by requiring local authorities to make MRP on such activity but noting that there are circumstances where an alternative approach may be suitable. The outcome of the consultation will be reported to members once it is known.

Expected Impact

5.9 In the context of the Council's financial position, the changes noted above are not considered to have a material impact on future borrowing plans or MRP calculations. However, they do reinforce that the Prudential Framework has changed significantly to mitigate the risk of local authorities using debt to invest for yield, and ultimately to discourage such behaviour.

6 Governance and Assurance

6.1 Under the existing scheme of delegation, approved as part of the Treasury Management Strategy in February, approval of the annual strategy is the responsibility of Council, with Audit Committee responsible for reviewing activity at least twice a year and Resource and Governance Scrutiny Committee responsible for reviewing policies and procedures.

6.2 There are no proposed changes to this following the revision of the Codes.

6.3 However, as noted above, the Codes do strengthen the requirement that members tasked with scrutiny of the treasury management function have access to relevant training.

6.4 It is proposed that officers will work with the Council's treasury management advisors, Link, to deliver a training session on treasury management to members and will follow this with an officer-led training session on the Council's approach to treasury management, ahead of the strategy setting process for the 2023/24 financial year.

7 TM Advisors

7.1 Under the scheme of delegation Audit Committee has responsibility to monitor the performance of the Treasury Management function which includes approving the selection of external service providers and agreeing terms of the appointment.

7.2 Whilst the Council's treasury management advisors could be considered an external service provider, historically the Audit Committee have not been asked to approve their appointment.

7.3 The delegation to Audit Committee is unusual and does not align with general procurement practices across the Council. The general practice is that procurement decisions are delegated to officers (principally Chief Officers, as per the Constitution) who are subsequently accountable for those decisions to members.

7.4 It is proposed that this function is delegated in the 2023/24 Treasury Management Strategy to the Deputy Chief Executive and City Treasurer, and report to members through the interim and outturn treasury management reports on any procurement relating to treasury management. This would require a change to the Council's constitution, and therefore it is proposed that it is recommended to Council to approve such changes to the constitution at the earliest opportunity to allow this to take effect.

8 Conclusion

8.1 There have been a number of significant changes to the prudential framework, with further changes currently being consulted on. The changes highlight risks to local authority balance sheets and revenue budgets that will now be more explicit in reports to members and will aid decision making.

8.2 The Council has a strong balance sheet position, does not invest solely for yield, and has a prudent debt management strategy. This means that the changes are not expected to have a material impact on the authority.