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Uttlesford District Council

Chief Executive: Peter Holt

SUPPLEMENTARY PACK

Investment Board

Date: Thursday, 11th November, 2021

Time: 6.00 pm

Venue: Zoom

Chair: Councillor N Reeve

Members: Councillors G Bagnall, C Criscione, N Hargreaves, A Khan, P Lavelle, G LeCount, J Lodge, R Pavitt, G Sell and J De Vries

Indpendent members: R White

ITEMS WITH SUPPLEMENTARY INFORMATION
PART 1

Open to Public and Press

To discuss the Prudential Code consultation and proposed changes to Minimum Revenue Provision and possible debt caps (to follow).

Uttlesford
District Council

Chief Executive: Peter Holt

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Committee:	Investment Board	**Date:** 11 November 2021
Title:	Prudential Code consultation and proposed changes to Minimum Revenue Provision and possible debt caps	
Report Author:	Adrian Webb, Director of Finance and Corporate Services awebb@uttlesford.gov.uk 01799 510421	

Summary

1. This report sets out details of a current consultation launched by the Chartered Institute of Public Finance and Accountancy (CIPFA) and proposes a draft response for formal approval. The report also provides an update on potential changes to financial rules that are currently being considered by the Government.

Recommendations

2. That Investment Board recommends Cabinet to;

    a. Agree the response to the CIPFA consultation as set out in Appendix One; and

    b. Note the position in respect of Minimum Revenue Provision and possible debt caps; and

    c. Confirm that there will be no additional investment portfolio acquisitions until the changes to financial rules, MRP and caps have been clarified.

Financial Implications

3. The Council's £275million investment portfolio generates a net annual revenue return (2023/24 forecast) of £7.1 million. This is used to offset the £16.2 million annual net core service budget. Changes to financial rules relating to investments by Local Authorities could in extremis result in a reduction in the Council's usable net revenue income of that £7.1 million.

Background Papers

4. The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

    Draft Prudential Code.

Impact

Communication/Consultation	Further communication and consultation will take place once the final implications of the changes are known
Community Safety	No specific implications
Equalities	None
Health and Safety	No specific implications
Human Rights/Legal Implications	The changes will need to be built in to the 2022/23 budget setting process to ensure a compliant and balanced budget is delivered
Sustainability	No specific implications
Ward-specific impacts	No specific implications
Workforce/Workplace	The changes are likely to have a direct impact on the workforce both in the short and medium term

Situation

CIPFA - Prudential Code Changes

5. On 21 September 2021 CIPFA launched an eight week consultation on proposed changes to the Prudential Code, to take effect from 1 April 2022 This is the guidance to which councils have 'to have regard to' when making any financial decisions.
6. There are a number of minor technical changes which have no material impact on the way the Council operates. However there are some specific proposed changes around commercial investments that could have a significant financial impact in the coming years.
7. In the previous versions of the Code, CIPFA has advised against commercial investments 'purely for yield'. Members will be aware that this Council obtained a QC Opinion confirming that UDC was not undertaking investments for yield, but instead to generate income to underpin core service delivery.
8. The proposed Code now has a new paragraph 51 which has changed the emphasis by rewording the guidance to 'An authority must not borrow to invest primarily for financial return'. This change removes the justification given in the QC Opinion, and effectively ends future commercial investments where that investment is primarily for financial return.
9. Whilst the sentiment from CIPFA is always that Code changes do not affect previous decisions made, paragraph 53, as set out, has implications for all

commercial investments by authorities where there is any element of short term financing.

> ‘Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting their financial investments for commercial purposes in their annual treasury management or investment strategies. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements.’

10. It would be reasonable for any fund be it a pension, local authority or other professional organisation to fund their portfolio through a mix of short, mid and long term borrowing. The second part of paragraph 53 states that

> ‘They should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead, based on a financial appraisal which takes account of financial implications and risk reduction benefits. Authorities with commercial property may also invest in the repair, renewal and updating of their existing commercial properties.’

11. Discussions have been held with senior officials at CIPFA and they have confirmed that paragraph 53 is not intended to be applied retrospectively. The Council’s existing portfolio would be considered ‘retrospective’ as the investments have already been made. Equally they appreciate that a literal interpretation of the wording as drafted could possibly suggest the need to sell existing assets and so they welcome proposals for revised wording, as they have stated that this is not their intent.
12. Therefore, in the response to the consultation the Council has proposed the following wording to CIPFA for paragraph 53

> ‘Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting their financial investments for commercial purposes in their annual treasury management or investment strategies, based on a financial appraisal which takes account of financial implications and risk reduction benefits. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements. Authorities with commercial property may also invest in the repair, renewal and updating of their existing commercial properties.’

13. This proposed amendment removes the line ‘‘They should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead’ and provides protection for the Council’s existing portfolio.

14. The reason for the proposed wording change is that most of the Council's investments are showing significant growth in value post acquisition, and while they could be sold now and deliver a profit even after the costs of sale have been deducted, that is not why they have been made. The reason the Council holds investments of these types is for the rental income which supports service delivery. Without the wording change, an unintended consequence of financial rule changes could be to force the sale of some or part of these assets quickly. This could leave a significant revenue shortfall which the Council would have difficulty in addressing, even though it would generate short term cash.

Government Changes

15. In addition Government is considering, not consulting on, a number of changes to also tighten up on council's who undertake commercial investments. Their intention is to protect the taxpayer from the financial difficulties that have been reported in the national newspapers at some local authorities that seem to have failed to have the robust investment criteria and risk management oversight that Uttlesford has. The two key changes that they are considering that could affect us are:
    a. Minimum Revenue Provision (MRP)
    b. Debt Cap
16. MRP is where a council would need to set aside an element of commercial revenue income each year to ensure that outstanding borrowing could be repaid at the end of a loan period.
17. Uttlesford already applies MRP, but at a rate of 0% on commercial assets as their residual value is forecast to exceed their purchase price. This is because the assets would be sold with both an existing tenant and a long lease still in place (greater than 10 years) to make it valuable to new owner. Typically the monies received from a sale would then be reinvested in new commercial assets.
18. In addition, there is no significant benefit for a council like ours to own the asset outright as the investment is for the annual rental income, which is obviously significantly reduced when applying MRP. The Council's commercial assets are funded 20% repayment loan and 80% interest only loans, which means at the appropriate time we could sell the asset for 80% of its original purchase price and still clear any debt outstanding on it. This is an extremely prudent approach, as when taking into account inflation, the Council had planned to sell the asset at the appropriate time to recover all of the initial outlay, thereby targeting at least a 20% profit on sale.
19. Government is considering imposing a debt cap in order to simply restrict how much some or all councils can borrow. If this is introduced, it is likely that this Council would receive such a cap. There is no information on the level at which such a cap might be imposed – i.e. whether it would be at our current level of borrowing, or at a higher, or lower level (the latter which would necessitate selling some of the Council's assets).

Summary

20. The Council's investments are sound and well managed. They have delivered significant financial benefit to both the Council and residents and will continue to do so for the next period. In addition, and as an added bonus, if they were to be sold most if not all will see the sale price exceeding the price paid when the asset was purchased.
21. Without these investments the Council would have faced significant financial challenges to core service delivery and recently would not have been able to allocate
    a. £1million to tackle Climate Change
    b. £1million to aid post-pandemic economic recovery
    c. £450,000 for sporting facilities across the district
22. Investments locally are for more reasons that generating income. As such, irrespective of rule changes, it is hoped that the Council, through Aspire (CRP) Ltd, will still be able to fully retain its 50% ownership of Chesterford Research Park as it is in the district, supports high-paying jobs and is strongly supporting the regeneration of our local economy. The same would be true of the Council's new business park investment in Little Canfield, where the Council is also basing some of its service delivery.
23. Officers are in dialogue with their opposite numbers in the Department for Levelling Up, Housing and Communities. In addition, the local MP, who is the new Minister for Local Government, has also been briefed.
24. The Council has already committed £275 million of the investment fund allocation of £300 million agreed by Council in February 2020. It was intended that the remaining £25 million sum would have been used to acquire Stane Retail Park 2. However, with upcoming likely changes in guidance, as a precaution the Council should not make any new investments until any rule changes are clear. This does not affect future development at Chesterford Research Park as this is part of the existing portfolio.
25. The investment portfolio generates a net annual revenue return (2023/24 forecast) of £7.1million. This is used to offset the £16.2million (2023/24 forecast) annual net service budget. If the Council was ultimately forced to sell part or all of its assets, it would result in a reduction in usable net revenue income of up to £7.1million per annum.
26. If this were to happen, the next five years could be challenging for the authority to balance service delivery demands with reducing revenue budgets.
27. Officers are currently mapping and testing possible alternative scenarios for the future of the commercial portfolio. These will be brought to a future Cabinet meeting for review.

CIPFA

The Prudential Code for Capital Finance in LocalAuthorities

Draft Code Consultation

Executive summary

CIPFA is pleased to publish the consultation on The Prudential Code for Capital Finance inLocal Authorities (2021) (Prudential Code) following the initial consultation on proposed amendments. CIPFA is grateful to the sector for the healthy response rate, with over 100 responses provided for each code consultation to provide evidence and support for the revised Code.

As guardians of the Prudential Code, CIPFA will ensure it is strengthened. Following the significant risk taken to protect this system by a few local authorities with public funds, the proposals outlined in this consultation clearly address that borrowing for yield only is a risk toprudent investment. Without these strengthened provisions, local authorities risk further government intervention in the Prudential Framework.

CIPFA is committed to the Prudential Code regime to ensure local decision making is protected and that local authorities can deliver service innovation under a principles-basedsystem. For the sector to continue to enjoy the freedoms of this system, the few outlying councils must end actions that either push the boundaries of the Prudential Code or intentionally misinterpret its provisions.

Following a review of each response we have received, the changes detailed in the code aresummarised in the below table:

	Material revisions to the Prudential Code (CQ refers to consultation question numbers)	**Prudential Code para**
1	A new Objective for proportionate commercial investments (CQ 3&4)	1(f)
2	Include the legal status of the Code in Chapter 3 (CQ 9)	12
3	Reference to environmental sustainability in contents of Capital Strategy (CQ 5)	24
4	Capital Strategy to summarise investments into treasury management, service and commercial purposes	24
5	Greater clarity on commercial and service investments in the Capital Strategy, including limits, and compliance with requirement not to borrow to invest for return (CQ 10)	24
6	Explicit requirement to set and monitor the treasury management prudential indicators in the TM Code LA Guidance	43
7	Quarterly monitoring of prudential indicators as part of normal budget monitoring reports	44
8	Replace old paragraph 45 (no borrowing in advance) with new requirement not to borrow to invest primarily for financial return (CQ 1&2)	48-52
9	Authorities with commercial financial investments who expect to borrow: annual strategy to review options for exiting commercial investments	53
11	New prudential indicator for net income from commercial and service investments as % of net revenue stream (CQ 13)	81-85

12	Investment Prudential Indicators to be reported together with investment indicators under Statutory Investment Guidance	83
13	Included Heritage Assets in definition of CFR	90
14	New definition of Commercial Property	92
15	remove deduction for interest and investment income from definition of Financing Costs	94
16	Revised definition of Investments (to include non-financial assets held primarily for financial return)	95
17	Sub-definitions for treasury management, service and commercial investments (CQ 10)	95
18	Clarification that Net Revenue Stream excludes capital grants etc	96
19	Consequential changes and cross references relating to the above items	throughout
20	Moved some procedural paragraphs into the Governance chapter	throughout

This Consultation asks 17 questions on the material revisions to the code and the table cross references to the page numbers which have been amended. CIPFA thanks you foryour time in responding to the Consultation on the Prudential Code.

The consultation closes on **16 November 2021.**

Question 1: Do you have any comments or observations on the amendments to the code relating to new Objective for proportionate commercial investments?

The changes to the code need to be clear, understandable and applicable without causing negative financial impact by inadvertently affecting previous financial decisions made under earlier versions of the Code.

Question 2: Do you have any comments or observations on the amendments to the code relating to the inclusion of the legal status of the Code in Chapter 3?

No comments to make

Question 3: Do you have any comments or observations on the amendments to the code relating to the reference to environmental sustainability in contents of Capital Strategy?

No comments to make

Question 4: Do you have any comments or observations on the amendments to the code relating to Capital Strategy's requirement to summarise investments into treasury management, service and commercial purposes?

This should already be easily identifiable so formalising it in this way is sensible.

Question 5: Do you have any comments or observations on the amendments to the code relating to the greater clarity on commercial and service investments in the Capital Strategy, including limits, and compliance with requirement not to borrow to invest for return?

It is important to have an informed and transparent strategy in place and this should incorporate acceptable limits in line with effective risk management.

The strategy should reference compliance with the Code but there has been some ambiguity regarding the classifications on 'investment for yield' and the proposed updated description of 'investment for return' makes this clearer to identify. Again, it should be implemented without causing negative financial impact by inadvertently affecting previous financial decisions made under earlier versions of the Code.

Question 6: Do you have any comments or observations on the amendments to the code relating to the explicit requirement to set and monitor the treasury management prudential indicators in the TM Code LA Guidance?

Agreed, this provides the reader with expectations and allows performance to be measured and manage risk accordingly.

Question 7: Do you have any comments or observations on the amendments to the code relating to the quarterly monitoring of prudential indicators as part of normal budget monitoring reports?

As above

Question 8: Do you have any comments or observations on the amendments to the code relating to the revision of 'Paragraph 45'?

We agree that there should be a prudent approach taken in the management of debt repayment and risk but feel this should be assessed against the type of asset the debt is financing and should be balanced against the exit strategy. It should also include the residual value as a method of repayment for outstanding debt/borrowing.

Question 9: Do you have any comments or observations on the amendments to the code relating to authorities with commercial financial investments who expect to borrow: annual strategy to review options for exiting commercial investments?

We understand and agree with the aim of paragraph 53. However as written will impact on investments made under previous versions of the code. All good property portfolios will have a mixture of short, medium and long term funding as that is a way of reducing risk. We would therefore suggest revised wording as follows, which effectively removes the need for a fire sale

‘Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting their financial investments for commercial purposes in their annual treasury management or investment strategies, based on a financial appraisal which takes account of financial implications and risk reduction benefits. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements. Authorities with commercial property may also invest in the repair, renewal and updating of their existing commercial properties.’

Question 10: Do you have any comments or observations on the amendments to the code relating to the new prudential indicator for net income from commercial and service investments as % of net revenue stream?

This seems a reasonable indicator, and one that the external reader could identify with and shows the reliance the Council has on generating additional income in order to deliver services.

Question 11: Do you have any comments or observations on the amendments to the code relating to the Investment Prudential Indicators to be reported together with investment indicators under Statutory Investment Guidance?

No comments to make

Question 12: Do you have any comments or observations on the amendments to the code relating to inclusion of Heritage Assets in definition of CFR?

No comments to make

Question 13: Do you have any comments or observations on the amendments to the code relating to the new definition of Commercial Property?

Not the principle, but it would be useful to further split the definition to those funded by authority balances and those funded by borrowing. Cash rich authorities should not be penalised for investing in commercial properties for financial return.

Question 14: Do you have any comments or observations on the amendments to the code relating to the removal of the deduction for interest and investment income from definition of Financing Costs?

No comments to make

Question 15: Do you have any comments or observations on the amendments to the code relating to the revised definition of Investments (to include non-financial assets held primarily for financial return)?

No comments to make

Question 16: Do you have any comments or observations on the amendments to the code relating to the clarification that Net Revenue Stream excludes capital grants and other items?

No comments to make

Question 17: Please detail any other comments on amendments to the code or further observations.

Uttlesford District Council, whilst having regard to the Prudential Code, has developed a professional approach to its commercial portfolio, using external advisers including areas such as land agents, lawyers and financial due diligence. We have in place an excellent governance structure to oversee the portfolio and it (the portfolio) has both appreciated in value and delivered all rental payments due throughout the pandemic.

Whilst our portfolio is complete, we had planned to sell existing assets and invest in new at the appropriate time, as good asset management plans would set out. However, we recognise that the new Code will bring to an end that ongoing investment strategy. We will, through option appraisals, regularly review the appropriateness of selling or retaining each asset, including the revenue income of those options.