



Council name	COTSWOLD DISTRICT COUNCIL
Name and date of Committee	AUDIT COMMITTEE – 27 JANUARY 2022
Report Number	ALLOCATED BY DEMOCRATIC SERVICES
Subject	REVISED PRUDENTIAL CODE AND TREASURY MANAGEMENT CODE
Wards affected	ALL
Accountable member	Cllr Mike Evely, Deputy Leader and Cabinet Member for Finance Email: Mike.Evely@cotswold.gov.uk
Accountable officer	Jenny Poole, Deputy Chief Executive Email: jenny.poole@cotswold.gov.uk
Summary/Purpose	The purpose of this report is to provide the Audit Committee with an update on changes to the Prudential Code and the Treasury Management Code published in December 2021.
Annexes	None
Recommendation/s	<i>That the Committee notes this update report and uses it to inform consideration of the draft Capital, Investment and Treasury Management Strategies for 2022/23 later in the meeting.</i>
Executive Summary	<p>The key changes to the two Codes are around permitted reasons to borrow, knowledge and skills and the management of non-treasury investments. There are also various amendments to the capital and prudential indicators.</p> <p>The TM Guidance Notes for Local Authorities and final details of the TM prudential indicators are current still in preparation.</p> <p>The Council's Capital, Investment and Treasury Management Strategies for 2023/24 will comply with all of the changes to the Prudential and Treasury Management codes and the cross-sectoral guidance notes.</p>
Corporate priorities	<p>The Council's revenue and capital budgets underpin the Council's Priorities:</p> <ul style="list-style-type: none">• delivering our services to the highest standards;• responding to the challenges presented by the climate crisis;• providing good quality social rented homes;• presenting a local plan that's green to the core;• helping residents and communities access the support they need for good health and wellbeing;

	<ul style="list-style-type: none"> • supporting businesses to grow in a green, sustainable manner, and to provide high value jobs
Key Decision	NO
Exempt	NO
Consultees/ Consultation	The Council responded to the Chartered Institute of Public Finance and Accountancy (CIPFA) consultation on proposed changes to the Prudential Code and Treasury Management Code in November 2021.

1. BACKGROUND

- 1.1. The Chartered Institute of Public Finance and Accountancy (CIPFA) maintains the Prudential Code and Treasury Management Code of Practice. The Prudential Code is used to ensure that capital finance decisions are financially sustainable, while the Treasury Management Code sits alongside to provide a framework for risk management of cash investments and borrowing.
- 1.2. CIPFA published its revised Prudential Code and Treasury Management Code of Practice in December 2021. The accompanying guidance notes have yet to be published.
- 1.3. This report provides the Committee with a summary of the changes introduced through the revised Codes. This document aims to provide a useful guide when the Committee considers the 2022/23 draft Capital, Investment and Treasury Management Strategies later in the meeting. Changes in the Prudential Code are reflected in the Treasury Management Code (and vice versa).

2. PRUDENTIAL CODE CHANGES

- 2.1. The new Prudential Code takes immediate effect from the publication date of 20 December 2021. Authorities are permitted however to defer introducing the revised reporting requirements, which would include revised reporting in relation to the Capital, Investment and Treasury Management strategies, until the 2023/24 financial year. As the guidance notes have yet to be published, the Deputy Chief Executive is proposing to exercise this option for the 2022/23 strategies. The Finance team will ensure that the 2023/24 strategies fully comply with the new Codes.
- 2.2. The new Prudential Code determines that authorities must not borrow to invest primarily for financial return and this requirement applies with immediate effect. This is a move away from the previous Code which stated that authorities must not “*borrow more than or in advance of need*”. The Code is now more prescriptive on what is considered to be prudent borrowing. Authorities may invest in maximising the value of commercial property, including repair, renewal and updating of the properties. The Code provides the following as examples of prudent borrowing:
 - 2.2.1. Financing capital expenditure primarily related to the delivery of a local authority’s functions;
 - 2.2.2. Temporary management of cash flow within the context of a balanced budget;
 - 2.2.3. Securing affordability by removing exposure to future interest rate rises;
 - 2.2.4. Refinancing current borrowing, including adjusting levels of internal borrowing, to manage risk, reduce costs or reflect changing cash flow circumstances;
 - 2.2.5. Other treasury management activity that seeks to prudently manage treasury risks without borrowing primarily to invest for financial return.
- 2.3. The Code’s objective that capital expenditure plans should be affordable has been expanded to include proportionality and a requirement has been included that “*plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services*”. As is customary at this Council, this requirement will be addressed within business cases for capital investment.

- 2.4. Authorities with an expected need to borrow are required to review options for exiting their financial investments for commercial purposes and to summarise the review in the annual Treasury Management and Investment Strategies. Officers are already reviewing the Commercial Property investment portfolio, similarly the value for money provided by the Council's long-term investment portfolio is considered against the cost of borrowing. The strategy documents will be updated for 2023/24 and capital financial proposals will reflect the outcome of these reviews.

Investment Categories

- 2.5. Investments will now be split into three broad categories:
- 2.5.1. Investments made for **treasury management** purposes;
 - 2.5.2. Investments made for **service** purposes – made to further service objectives;
 - 2.5.3. Investments made for **commercial** purposes – primarily for financial return.
- 2.6. Further guidance is expected to be published in the Treasury Management Code Guidance Notes for Local Authorities. Local authorities with borrowing will be required to classify investments in equities, bonds and property as 'investments for commercial purposes'.

Capital Strategy

- 2.7. The Capital Strategy from 2023/24 is required to include:
- 2.7.1. How capital expenditure is prioritised in relation to the strategic priorities and policies of the authority, such as affordable housing, regeneration and environmental sustainability;
 - 2.7.2. A section on liquidity risk and borrowing sources for authorities with restricted or no access to PWLB;
 - 2.7.3. A projection of investments (where material) analysed between investments for treasury management purposes, service purposes and commercial purposes;
 - 2.7.4. The authority's approach to investments for service or commercial purposes including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
 - 2.7.5. An assessment of affordability, prudence, and proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);
 - 2.7.6. Details of financial and other risks of undertaking investments for service or commercial purposes, and how these are managed;
 - 2.7.7. Limits on total investments for service purposes and for commercial purposes, respectively; and
 - 2.7.8. A statement on compliance with paragraphs 51 to 53 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return.

Prudential Indicators

- 2.8. There is a new requirement for forward-looking prudential indicators to be monitored and reported to Members at least quarterly as part of the revenue and capital monitoring. This

will be implemented during 2023/24 and will align with the indicators included within the revised strategies from that year.

- 2.9. A new prudential indicator has been added: “*net income from commercial and service investments to net revenue stream*” as a measure of proportionality. A similar measure with usable revenue reserves instead of net revenue stream is suggested as a local indicator.
- 2.10. There are some technical adjustments to the prudential indicators, the most significant being the requirement to exclude interest and investment income from capital financing costs. Previously the calculation included interest payable on borrowing less income receivable from investments so the net cost of borrowing was reported. This change aids transparency as the full cost of capital financing is now considered.

Treasury Management Code (TM Code)

- 2.11. Unlike the Prudential Code, there is no mention of the implementation date for the TM Code. The Deputy Chief Executive is following the same process as with the Prudential Code, delaying changes to the strategies until the 2023/24 financial year.
- 2.12. The TM Code will require a formal adoption of a policy to create and maintain investment management practices (IMPs) for investments that are not for treasury management purposes, for example investments in town centre regeneration or solar energy. The Treasury Management Policy statement will also require a technical change to refer to high level policies on “treasury management” rather than the previous “investment and borrowing”. Council will be asked to formally approve these amendments as part to the budget setting process in 2023/24.

Treasury Management Practices

- 2.13. Treasury Management Practices (TMPs) underpin operational treasury management activity. There are various technical changes required to TMPs which will be addressed by Officers such as renaming TMPs or updating TMPs to align with the changes in the Prudential Code and TM Code as set out in this report. More significantly, there is a new requirement for TM policies and practices to include environmental, social and governance (ESG) investment considerations. Work is currently underway on including and referencing environmental, social and governance elements in the Council’s TM Policy which will be presented to full Council during 2022/23.

Service and Commercial Investments

- 2.14. There are additional requirements for service and commercial investments. Examples of service investments include: investment in operational assets such as car parks, housing, vehicles and equipment and investment in the systems used by staff to deliver services. Examples of commercial investments include investment in property with the primary aim of delivering a financial return or treasury investments in equities or bonds. The TM Code introduces additional reporting requirements including:
 - 2.14.1. Clear identification and reporting in appropriate categories;
 - 2.14.2. Description of the investment purposes, objectives and management arrangements;
 - 2.14.3. Setting out the level of risk and the arrangements for managing risk;
 - 2.14.4. Addressing all the organisation’s investments in its TM policy statements, strategies and reports;

- 2.14.5. Applying an appropriate investment risk management approach across all non-treasury management investments;
- 2.14.6. Noting that risks associated with investment should be proportionate to the organisation's financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
- 2.14.7. Ensuring that robust procedures for the consideration of risk and return are applied;
- 2.14.8. Preparing and maintaining investment management practices (IMPs) which categorise non-treasury management investments and plans into appropriate portfolios (or individual major investments) reflecting their different purposes, objectives, and management arrangements;
- 2.14.9. Setting out in a schedule to the IMP the investment objectives, investment criteria, risk management arrangements, decision-making and reporting arrangements, performance measurement and management, and arrangements for training and qualifications for each portfolio.

Cross-sectoral guidance notes

- 2.15. The guidance notes were not subject to consultation but have been published alongside the revised Prudential and Treasury Management Codes. There is a new requirement to define the local authority's risk appetite, which includes:
 - 2.15.1. Providing an overall assessment of the authority's risk appetite, which governs the policies and strategies the organisation uses to manage risk;
 - 2.15.2. Including consideration of a range of risk scenarios and their impact on the revenue budget in relation to the organisation's capacity to absorb adverse impacts;
 - 2.15.3. Reaching a view about the acceptable level of treasury budget variance the organisation can reasonably manage and setting risk limits accordingly.
- 2.16. The section on managing treasury risks includes the statement that "*the treasury function's primary role in the public services is to manage the net risk exposures that result from the organisation's activities and financing. It is not the purpose of the treasury function to increase risks primarily in order to earn financial returns.*" This links to the review of investments required before undertaking new borrowing, as set out at 2.4 above.
- 2.17. Councils are now required to include a liability benchmark in the Capital Strategy to enable consideration of an alternative, lower level of borrowing than that proposed by the use of the Capital Financing Requirement. The aim being to avoid borrowing too much, too little, too long or too short. The Council has previously included a liability benchmark in its Capital Strategy. However, use of this to support decision making will be enhanced in the 2023/24 Capital Strategy.
- 2.18. The TM strategy may be approved by a sub-committee if full Council approves a Capital Strategy containing certain minimum items. In this case the guidance suggests that a separate scrutiny committee for treasury management may be appropriate in order to ensure an appropriate level of challenge. However, the Deputy Chief Executive is proposing to maintain the current practice of full Council approving the Treasury Management Strategy. The Audit Committee currently demonstrates its ability to provide an appropriate level of scrutiny and challenge on treasury management and investment decisions and has the ability to report both to Cabinet and Council.

2.19. The guidance notes also include enhancements to the schedules relating to training and qualification. Schedules are recommended for key roles, knowledge and skills, and monitoring and review.

3. Summary

3.1. The key changes to the two Codes are around permitted reasons to borrow, knowledge and skills and the management of non-treasury investments. There are also various amendments to the capital and prudential indicators.

3.2. The TM Guidance Notes for Local Authorities and final details of the TM prudential indicators are currently still in preparation.

3.3. The Council's Capital, Investment and Treasury Management Strategies for 2023/24 will comply with all of the changes to the Prudential and Treasury Management codes and the cross-sectoral guidance notes.