CIPFA BULLETIN 04

Treasury and Capital Management Update

April 2020

The Treasury and Capital Management Panel oversees the production of CIPFA Bulletins to assist practitioners with the application of the requirements of the Prudential and Treasury Management Codes, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of Prudential or Treasury Management Codes.

Please address any queries to CIPFA Technical Enquiry Service for CIPFA members and students
technical.enquiry@cipfa.org.uk

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INTRODUCTION

1. The Treasury and Capital Management Panel has responsibility for the Prudential Code and the Treasury Management Codes and their associated guidance. The Panel's aims are:

   - to enhance the skills and expertise of treasury management staff and those charged with governance
   - to support and promote best practice, along with the Treasury Management Network, in the effective understanding and management of treasury risks
   - to promote effective strategic capital planning.
   - the continued development of effective asset management planning to ensure the most effective utilisation of assets
   - to develop the scope of the panel to ensure that cross-sectoral and devolved government agendas are addressed.

2. This CIPFA Bulletin covers a number of issues that CIPFA considers would be useful to highlight for practitioners. However, this should not replace direct reference to the Prudential and Treasury Management Codes, the *Code of Practice on Local Authority Accounting in the United Kingdom* and the relevant statutory provisions for the prudential framework across the UK.

CORONAVIRUS – COVID 19
(The following section was first included in CIPFA's Briefing to Chief Financial Officers – April 2020.)

3. The CIPFA Treasury and Capital Management Panel has identified a number of key issues which need to be considered as result of the COVID-19 pandemic.

   Cash flow management

4. The Panel would recommend that day-to-day cash flow management is prioritised during and immediately after the COVID-19 period. Forecasted cash flows are likely to be on a downward trend for the medium to long term. Alternatively, the new grant awards may lead to temporary surpluses. These should be considered against the authority's normal monitoring of and any breaches should be reviewed and reported. Assumptions will need to be transparent and local authorities will need to consider the financial control systems required to gather as much information as possible on key significant items of expenditure and income that will impact on cash flows, such as:

   - the timing for likely changes to the major schemes in the capital programmes
   - the impact of the pandemic on service provision (eg the cash impact of delivering services in different ways)
   - new or different levels of grant income
   - overtime or special arrangements for key workers
   - changes to policy such as the changes to business rates
   - consideration of the impact of the pandemic on other receivables such as council tax or housing rents.

Liquidity

5. The impact of the various cash flow scenarios described above will create greater uncertainty over the amount and timing of cash flows collected by local authorities. It is likely that local authorities will need to keep under review the liquidity of their investment portfolios and make cash available in the shorter term. Local authorities may also need to consider their ability to be able to convert investments to cash at short notice and even the liquidity of their longer-term investments.

Security

6. Practitioners will be aware that a key part of treasury management is the management of risk and the protection of the principal sums invested. Local authorities will therefore want to consider the impact of COVID-19 on the approach to their treasury management activities.

Local authority prudential indicators

7. It is recognised that during the unprecedented circumstances brought about by the pandemic local authorities may need to borrow in the short or medium term more than they had originally planned, and may potentially need to borrow in excess of their agreed limits on the prudential indicators prescribed in the *Prudential Code*. Paragraph 29 of the *Prudential Code* in accordance with the provisions of the Local Government Act 2003 allows local authorities to respond to unforeseen and extraordinary circumstances. Paragraph 29 sets out that:

   Where Section 5 of the Local Government Act 2003 (England and Wales) applies:

   - *(1)* Subject to subsection (2), any limit for the time being determined by or for a local authority under Section 3, or applicable to it under Section 4, shall be treated for the purposes of this Chapter as increased by the amount of any payment which– (a) is due to the authority in the period to which the limit relates, but (b) has not yet been received by it.

   - (2) In the case of a limit determined under Section 3, or set under Section 4(2), subsection (1) shall not apply to any payment whose delayed receipt was taken into account in arriving at the limit.

Operational risks and contingency planning

8. Local authorities will need to consider the control and operational procedures in place to ensure that treasury management teams have facility to operate day to day operations remotely without need to have personnel in local authority buildings. Local authorities will need to ensure that there is a robust control framework for the authorisation of payments. It is likely that Treasury Management Practice 5: *Organisation, Clarity and Segregation of Responsibilities*, *and Dealing Arrangements* and Treasury Management Practice 6: *Reporting Requirements and Management Information Arrangements* will need to be reviewed and updated.

Capital Programme Management

9. It is likely that local authorities will need to consider the effect of a number of key risks to current capital programmes such as:

   - market volatility – impact on affordability of capital programmes, for example price inflation and costs of associated borrowing

- the impact of the ‘stay at home’ measure on programmes

- risks to contractors due to COVID-19.

Councils may need to assess the impact on the future development of the programme and the impact on revenue and capital budgets. Scenario planning and sensitivity analysis will assist in this and should focus on current and future proposals, including future borrowing costs and the changing economic environment.

Governance Arrangements

10. Local authorities are likely to need to review their governance arrangements for both their treasury and capital management activities. These are likely to be affected by the current ‘stay at home’ requirements, which limit public gatherings to two people and restrict the ability of people to leave their homes except for very limited purposes. Added to this, staff may be redeployed to urgent tasks and both staff and local authority members may not be available due to illness. Separate regulations have been made to enable meetings to be held remotely. Local authorities will need to ensure that they have in place appropriate mechanisms to allow for remote working and for remote procedures to agree their capital strategy, prudential indicators and statutory investment strategies. This should as far as possible follow the principles of the *Prudential Code*.

Credit Risk

11. Local authorities will need to ensure that they have appropriate arrangements to manage credit risks. Low-risk options will need to be considered.

CIPFA TREASURY MANAGEMENT PANEL – RISK HORIZON SCANNING

12. The Treasury and Capital Management Panel undertakes regular risk appraisals relevant to local authority treasury management. The following provides an indication of the risks they have considered; but the list of risks is not exhaustive and does not include local risks. Local authorities may wish to review them against their own assessments of the risks they are considering and whether they might impact on their treasury management strategies and policies:

- Interest rate changes risks
  - councils run down cash holdings and are challenged by a sudden loss of market liquidity/or cost of liquidity
  - potential impact on interest rates of non-standard monetary policy instruments or actions.
- Credit and counterparty risks
  - default of one or more of the Euro countries leading to freezing of bank lending and possible € bank failures
  - a money market fund or fund manager gets into difficulties
  - potential further downgrade of low-rated UK clearing bank to close due to ‘junk’ status/bail in risk
  - Impact of COVID-19 (coronavirus multiple business failure in region, effects on tax base economic activity.
- Regulatory risks

- government acts against 'excessive' local authority reserves (cash and/or balances conflated in the process)
- assessment of the probability/possibility of no trade agreement with EU as at 31 December 2020
- other geopolitical risks, lack of international coordination due to populist leaderships
- impact of cyber attacks
- multiple tenancy delinquencies – failure of shopping centres, business parks etc, impact on debt financing.

- Capital management/capital financing

  - increased scrutiny of council asset base and 'pressure' to sell assets
  - risks associated with third party project funding contained risks, especially through the pricing of any guarantee that might be proposed. Pressure to bail-out local schemes. Project guarantees being enforced as a result of funding difficulties.

IMPLICATIONS ON PWLB INTEREST RATE RISE

(*See also section on consultation by HM Treasury on proposals for changing PWLB lending terms in the next section.*)

13. Following the rise in October 2019 of the borrowing rate for local authorities with the Public Works Loan Board (PWLB), the margin on borrowing over corresponding gilts may give rise to private markets offering competitive borrowing options for local authorities to finance capital programmes across the UK.

14. Local authorities will have a number of options to finance local authority capital expenditure:

    - continuing to finance through PWLB at the new rate
    - reducing or delaying elements of the capital programme
    - seeking to fund through other sources of finance within the authority eg revenue or capital receipts (though it is recognised that these sources are increasingly limited for local authorities)
    - seeking alternative funding solutions (which may not be limited to private market offerings).

15. As with all capital financing decisions it will be important that they are properly evaluated and risk managed using the principles of the Prudential and the Treasury Management Codes. Borrowing will need to be sustainable, prudent and affordable, with a full understanding of the risks and impact on the authority. This will include:

    - a full option appraisal against other alternatives – this will also need to consider options for postponement and not proceeding with the scheme or particular elements of capital expenditure plans
    - an impact analysis on the authority's future finances, ensuring that this is fully understood by the authority in both the medium- to long-term and taking into account future changes in the economic environment
    - an assessment of accounting consequences before entering into the transactions, including the impact on the authority's general fund

- a full evaluation of the refinancing risks

- for new or 'innovative' transactions – an assessment of whether the authority and its decision makers have appropriate skills and experience to make the relevant assessments

- consideration of the impact that the new financing option will have on its capital strategy.

HM TREASURY CONSULTATION – PWLB: FUTURE LENDING TERMS

16. The 11 March 2020 Budget Report stated:

Local authorities also invest billions of pounds of capital finance every year in their communities. The government supports this activity, in part, by offering low-cost loans through the Public Works Loan Board (PWLB). However, in recent years a minority of councils have used this cheap finance to buy very significant amounts of commercial property for rental income, which reduces the availability of PWLB finance for core local authority activities. To address this the government will consult on revising the terms of PWLB lending to ensure LAs continue to invest in housing, infrastructure and front-line services.

17. HM Treasury launched the consultation Public Works Loan Board: Future Lending Terms on a number changes to the PWLB borrowing for local authorities on the same day. The proposals include measures that would specifically prevent borrowing from the PWLB to fund commercial assets.

18. As starting point, the government proposes:

- requiring local authorities that wish to access the PWLB to confirm that they do not plan to buy investment assets primarily for yield

- publishing guidance defining the activity that the PWLB will no longer support, with clear protections for service delivery, regeneration, housing, and the refinancing of existing debt

- standardising the information currently gathered through the application process for the PWLB Certainty Rate and using this as the primary way to confirm with local authorities that their plans conform with the guidance.

19. The government intends to lower the interest rate on new PWLB loans in the future, subject to market conditions, once a new system can be introduced to address the debt-for-yield issue.

20. It is understood that as part of this consultation, the government will run a series of regional roundtables with local authorities in England, Scotland, and Wales, the MHCLG, the Scottish and Welsh Governments and CIPFA.

21. The consultation also announces that the government is cutting the interest rate on new loans for social housing and has offered over £1bn of discounted lending for high-value local infrastructure projects. The proposed rate would be cut by 1% to assist the funding of housing projects.

22. In addition, HM Treasury proposes new guidance defining the activity that the PWLB will no longer support "with clear protections for service delivery, regeneration, housing, and the refinancing of existing debt".

23. The consultation period closes on **Thursday 4 June 2020**.

24. A statement from the CIPFA Chief Executive on the proposals is included in the Appendix to this Bulletin.

MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID II) – A REMINDER

(The following is an extract from CIPFA BULLETIN 02 – October 2018.)

25. Practitioners are reminded that the process for electing to opt up to professional status with financial institutions is a continuous process and is not a one-off transaction.

26. While financial institutions will make decisions on clients electing to opt up, local authorities are responsible for the information they have provided including updating that information when there are significant changes. These changes could include staffing changes within the treasury management team or a change to the CFO, plus any major changes to the elected members with decision-making responsibilities or local authority appointed advisors. It is expected the financial institutions will look to refresh the data annually, but local authorities should not wait to rely on this process.

BANK OF ENGLAND UK MONEY MARKETS CODE

27. The *UK Money Markets Code* was published in April 2017. The Code sets out the standards and best practice expected from participants in the deposit, repo and securities lending markets in the UK.

28. CIPFA commends the *UK Money Markets Code* to its members as good practice to which they should adhere. Copies of the UK Money Markets Code can be obtained from the Bank of England's website.

29. Adherence to the Code can be affirmed by a standard statement of commitment to the principles underlying the Code, and this can be demonstrated by appearing on the Public Register via UKMoneyMarketsCode@bankofengland.co.uk.

30. Further information can be found in:
    - ACT Briefing note for corporates: UK Money Markets Code (July 2017)
    - The UK Money Markets Code (April 2017) and Explanatory Notes (May 2018).

CIPFA FINANCIAL SERVICES QUALIFICATION

31. In partnership with Intuition Know-How, CIPFA continue to offer online learning materials and activities to help you develop your knowledge and skills at your own location and pace as well as supporting the requirements of Markets in Financial Instruments Directive (MiFID II). The e-training platform has over 500 tutorials.

32. Find out more at: http://www.cipfa.org/training/e-learning-materials/financialservices-e-learning.

33. In addition, CIPFA has developed a recommended learning path which will provide direction for those that require it and will result in the award of a CIPFA certificate for successful completion, which can be used for CPD purposes.

34. The coverage extends to all areas of financial services such as:

- corporate and commercial banking
- investment banking and capital markets
- financial analysis and valuation
- credit and risk management
- regulation and compliance
- asset management.

35. For more information and to register please contact: E: vlesupport@cipfa.org.

Appendix

CIPFA Chief Executive Statement on the Proposals for Changing PWLB Lending Terms

On 11 March the CIPFA Chief Executive issued the following statement:

CIPFA has noted the proposed modification to PWLB borrowing requirements.

This represents one of the most significant interventions by government since the inception of the Prudential Framework in April 2004.

CIPFA understands that the underlying rationale for the proposed measures is to first prioritise the use of PWLB for investment in services and local regeneration, and secondly the related aim to dampen the extent to which local authorities undertake borrowing to invest in commercial property purely for commercial gain by removing the PWLB as a borrowing route.

That rationale is consistent with statutory guidance, the Prudential Code, and is entirely consistent with CIPFA's messaging on this matter.

Consequently, CIPFA welcomes these proposed changes to PWLB rules, whilst also expressing regret that the behaviour of some authorities has given rise to these changes which will affect all councils.

CIPFA takes this opportunity to remind local authorities of their legislative responsibility to 'have regard' to the Prudential Code. For CIPFA members, adherence to the Code is of course a mandatory requirement of membership.

More widely it forms a professional requirement for all accountants working in local government to follow CIPFA guidance.

Local authorities and professional accountants must have regard to the spirit of the prudential framework as an enabling regime rather than view it as a prescriptive framework where rules can be interpreted at the margins. As a result, it represents a flexibility in public financial management which, in the opinion of CIPFA, should be jealously guarded by all stakeholders.

In relation to the proposals by HM Treasury, CIPFA advises all CFOs to operate these new arrangements with immediate effect.

When regulations follow consultation, we believe that they will apply to both financing and refinancing, and so councils should avoid the risks that could result if they borrowed from the PWLB for commercial purposes during the transition.

Government has acted with clarity on the use of the PWLB and this note advises CFOs to maintain professional conduct in the eyes of stakeholders and the Institute by acting in the spirit of this.

More widely, CIPFA would remind all decision makers that the requirements of the Prudential Code are not limited to any particular form of borrowing or financial instrument.

The policy intention is clear and CIPFA's recent guidance entitled Prudential Property Investment was designed to enable local authorities to navigate the decision making behind borrowing and investment for commercial property related matters.

The proposed intervention by HM Treasury could signal a move towards a more prescriptive framework, which CIPFA considers all stakeholders have an interest in avoiding.

The most appropriate way to safeguard the current framework is to demonstrably have regard to the Prudential Code and to be advocates for the principles therein.

Finally, CIPFA notes that the government has said that it intends to lower rates on all new PWLB loans once a robust system is in place and market conditions allow.

We therefore encourage councils to respond on this point in the consultation period.