



# Todmorden Town Council

## Reserves & Treasury Management Policy

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Date: March 2024

Review: Annually

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## **1. Purpose**

- 1.1 Todmorden Town Council (the Council) is required to maintain adequate financial reserves to meet the needs of the organisation. The purpose of this policy is to set out how the Council will determine and review the level of reserves.
- 1.2 The level of reserves required will vary according to local circumstances and will be informed by longer-term spending plans. There is no specified minimum or maximum level of reserves that an authority should hold.
- 1.3 It is the responsibility of the Responsible Financial Officer (RFO) and Councillors to determine the level of reserves and to ensure that there are procedures for their establishment and use.
- 1.4 The Good Councillors Guide to Finance and Transparency 2017 suggests that a council should typically hold between 3- and 12-months expenditure as a general (revenue) reserve. If the reserve is too low then it may not be enough to cover unexpected expenditure or emergencies, whilst if it is too high then local electors have paid a tax which is not being used for the benefit of the local community.

## **2 Legislative/Regulatory Framework**

- 2.1 The requirement for financial reserves is acknowledged in statute. Sections 43 of the Local Government Finance Act 1992 require billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.
- 2.2 There is also a requirement reinforced by section 114 of the Local Government Finance Act 1988 which requires the RFO to report to all the authority's councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the authority will not have the resources to meet its expenditure in a particular financial year.
- 2.3 Furthermore, sections 26 and 27 of the Local Government Act 2003 set out the requirements regarding the determination of minimum levels of controlled reserves (i.e. currently unallocated balances), and actions required should they fall below such minimum levels.

## **3 Types of Reserves**

- 3.1 Revenue Reserves can be categorised as "general" (held to cushion the impact of uneven cash flows or unexpected events) or "earmarked" (held for a specific purpose).
- 3.2 Earmarked Reserves can be held for several reasons. As the name suggests the Reserves comprise amounts which are "earmarked" for specific items of expenditure to meet known or predicted liabilities or projects.
- 3.3 Earmarked Reserves can be used to "smooth" the effects of certain expenditure commitments over a period of time thereby reducing the impact of significant expenditure in any one year.
- 3.4 "Earmarked" reserves are typically held for four main reasons:
  - a) Renewals – to plan and finance an effective programme of equipment replacement, planned property repair and maintenance or grounds maintenance. These reserves are a mechanism to smooth expenditure so that a sensible replacement programme can be achieved without the need to vary budgets. Earmarked Reserves currently include, for instance, annual provisions towards the

potential of Elections, or specific projects requiring funds to be reserved to ensure they can be delivered from a financial point of view.

b) To carry forward an under-spend - some projects have ring-fenced budgets that may be under spent in a specific year. Earmarked Reserves are used as a mechanism to carry forward these resources.

c) To indicate commitment to capital projects.

d) Other earmarked reserves - may be set up from time to time to meet known or predicted liabilities.

3.5 **As of 5<sup>th</sup> February 2024, Earmarked Reserves stand at £450,851 \*\***

A full list is shown in the monthly management accounts and the year-end Financial Statements.

3.6 Earmarked Reserves are established on a “as needs” basis in line with anticipated requirements. Councillors review the levels and are required to approve any additions or reductions and to confirm balances to carry forward at the end of each financial year.

3.7 Any decision to transfer balances from the Revenue Reserves must be reviewed by the Resources Committee and recommended to Full Council for formal approval.

3.8 Expenditure from Reserves is subject to compliance with the Council’s Financial Regulations.

#### **4. Principles to Assess the Adequacy of Balances and Reserves**

4.1 A Considerable degree of professional judgement is required in making any financial assessment and the RFO is expected to provide advice with the help and possible guidance from Councillors and other advisory sources.

4.2 Setting the budgets is the responsibility of the individual Committees in collaboration with the RFO, reviewed by the Resources Committee and a recommendation then made to Full Council for ratification and formal approval. This forms the foundation of setting the precept.

4.3 In order to assess the adequacy of Reserves when setting the budget, both the RFO and the Committees should take account of the strategic, operational and financial risks facing the Committees / Council. The financial risks should be assessed in the context of the Council's overall approach to risk management.

4.4 The RFO should ensure that the Council has put in place effective arrangements for internal audit of the control environment and systems of internal control.

4.5 Setting the level of Reserves is just one of several related decisions in the formulation of the long- and medium-term financial strategy as well as the budget for a particular year. Account should be taken of the key financial assumptions underpinning the budget alongside a consideration of the Council's financial management arrangements.

4.6 In addition to the cash flow requirements of the Council the following factors should be considered:

a) Inflation and interest rates – consider borrowings/debts and inflationary pressure on rental income, salaries, utilities and other contracts and purchase requirements.

b) Estimates of the level and timing of future capital receipts.

c) The Town Council's capacity to manage in-year budget pressures, particularly where demand can lead to pressure.

- d) Planned efficiency savings / productivity gains.
- e) The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements, or major capital developments.
- f) The adequacy of the insurance arrangements to cover major unforeseen risks.

**5. Recommended levels of General Revenue Reserve**

- 5.1 The Council's revenue related expenditure is circa £430,750 (excluding one off grant related capital projects) and precept income of £409,550 the RFO recommends that the general revenue reserve should stand at a median figure of around £100,000, as a general revenue reserve to cushion cash flows or for unexpected events.
- 5.2 Whilst this is equivalent to just over four months expenditure, the nature of the council's activities is not high risk. We do not own buildings or operate direct delivery services with substantial financial impact. The level proposed meets minimum guidelines but is not over cautious.
- 5.3 The current Earmarked Reserves provision of £450,851 includes within it, some areas that potentially could be transferred back into General Reserves and provides some additional comfort if needing to be called upon for general expenditure. This is kept under regular review at each Resources Committee meeting. It also includes a element of Town Deal funds, in restricted EMRs.
- 5.4 External Grant Funding of substantive nature, when bought back into revenue budgets to action, can alter this ratio implying that 3 months cover of revenue budget would require a larger increase in General Reserves provision to be made
- 5.5 The nature of external grant funds are that they should be matched with related expenditure and therefore not related to the normal course of everyday business. As such all grant related expenditure should be deducted from overall revenue spend to arrive at the level of General Reserves to be maintained as a buffer.

**6. Recommended levels of Earmarked Reserves**

- 6.1 In view of both known commitments and future ambitions the RFO recommends that the following levels of Earmarked Reserves are formally established in the Council's Balance Sheet as of year-end 31<sup>st</sup> March 2024.

Title	Amount	Purpose	Anticipated length of Reserve	Future years intention to build up increased amount
Emergency flood repair	£20,000	High risk of flooding. Contingency to assist local residents in case of need	Ongoing	No
Elections	£10,483	To meet cost of all out elections for 2027 with £5,000 revenue addition 24/25	Ongoing	Yes - subject to review
Community Development	£50,000	Designed to help lever in greater investment by way of matched funds type contribution.	Ongoing	From surplus year end General Reserve or transfer from other Earmarked Reserve.

Title	Amount	Purpose	Anticipated length of Reserve	Future years intention to build up increased amount
Festive Lights Replacement	£31,600	New festive lighting scheme introduced in 2020 – estimated to replace year 8	Ongoing for 7 years	Within budget set each year to increase to £60,000
Remembrance Parade	£2,500	Potential to need to deliver event from 2022	Review need 24/25	No – then from revenue budget
Non- Precept grant phasing	£44,151	Potential of non - precept grant income being reduced by CMBC- financial contingency	Needed in 2024/25	No
Budget Phasing	£4,333	Contingency to meet budget requirement over 3-year period where year 1 indicated revenue shortfall	Ongoing	No
Year- end Commitments	£3903*	To provide for known revenue projects and or commitment made	Within 2024/25	Subject to review and need
Benches	£10,000	To provide for project to review condition of Benches	Within 2024/25	Subject to review and need
Defibrillators	£7,000	To provide for project consumables or replacements for the 6 being installed	Within 2024/25	Yes
WNW Community Garden	£1,000	Sponsorship money for community garden contribution	Within 2024/25	No
TIB funding Gap	£5,000	To meet shortfall of installation cost passed on by CMBC	Within 2024/25	No
Climate Emergency projects	£7,500	To meet anticipated costs of project delivery	Within 2024/25	No
Town Deal Contribution	£7,500	To meet anticipated costs of project delivery	Within 2024/25	No
Neighbourhood Plan	0	To be changed to N Plan Review	Review every 5 years	No
Centre Vale Project Development Group	£5000	To meet cost of providing Sponsor support	Within 24/25	No
Staffing	£3,500	To meet any additional staff cost requirements such as Pay increases or overtime	Within 2024/25	Subject to review and need
Town Deal Revenue Restricted Fund	£6,700	Balance of Town Deal Business Case Revenue Fund	By Dec 2024	If unspent to be transferred into Restricted Capital Fund

Town Deal Restricted Capital	£218,181	Advance fund from CMBC to enable contract to be placed	Within 24/25	No
Centre Vale Project Property Maintenance	£12,500	For Bowling Pavilion and Bandstand Maintenance	Ongoing	Yes – Revenue commitment £25k per annum – any balance unspent to be added to this reserve.
<b>Total</b>	<b>£450,851</b> **			

\*\* This included external funds for the Town Deal Centre Vale Projects.

\* The Year End Commitment Earmarked Reserve of £13,315 is established in respect of the following known commitments/ projects to be completed.

#### Proposed additional EMRs for 24/25

EMR - Vale Land community Garden	£6,000
EMR - Land Transfer legal fees	£3,903
EMR - N Plan review	£10,000
EMR - Centre Vale Property	£5,000

EMR Carry Over 23/24 into 24/25			
Centre	Code	Title	Amount
150	4632	Lobb Mill	£5,415
200	4638	Benches	£2,500
120	4145	Office & It Equipment	£1,500
150	4634	Vale Land	£500

**Total** **£9,915**

## 7 Additional Reserves – Community Infrastructure Levy and Capital Receipts

- 7.1 Although not currently applicable, future housing development in the area may release such a levy.
- 7.2 Community Investment Levy (CIL) Reserve represents the value of CIL funds passed over to the Council from Calderdale Metropolitan Borough Council, but which has yet to be spent on infrastructure items by the Town Council.
- 7.3 CIL funds are to be kept in a separate reserve in case of need of return, if not spent in accordance with the specified agreement.
- 7.4 Usable Capital Receipts Reserves represent capital receipts available to finance capital expenditure in future years.

## 8 Monitoring and Reviewing Reserves

- 8.1 General Revenue Reserves will be reviewed at each year end in conjunction with the year's surplus or deficit being added or subtracted.

- 8.2 Then forecast year end level of general reserves will form part of The Councils periodic monitoring processes and specifically considered at each meeting of the Resources Committee.
- 8.3 At all times there must be kept a minimum balance sufficient to pay three month's salaries to staff and on costs. For 2024/25 three months' salaries would amount to circa £40,000.
- 8.4 As part of the annual review, Councillors will be asked to consider a transfer of all or part of the value of net gains on Revenue year, end against year start forecast to move into the Community Development Earmarked Reserve.
- 8.5 Should the Revenue General Reserves at year end fall below the recommended level then this will be addressed by transfer back from Earmarked Reserves with the first call on the Community Development Fund.
- 8.6 Reviewing the Council's Financial Risk Assessment is part of the annual budgeting by Committees and the year-end accounting procedures. Part of this process may identify planned and unplanned expenditure items and thereby indicate where specific additional reserves may need to be added to Earmarked Reserves.

## **9 Treasury Management**

### **9a Strategy**

- 9a.1 Todmorden Town Council acknowledges the importance of prudently investing the temporarily surplus funds held on behalf of the community.
- 9a.2 This Strategy complies with the revised requirements set out in the Department of Communities and Local Government Guidance on Local Government Investments (Appendix A) and takes into account Section 15 (1) (a) of the Local Government Act 2003 and guidance within Governance and Accountability for Local Councils Practitioner's Guide.
- 9a.3 The Local Government Act 2003 states that a local authority may invest for any purpose relevant to its functions under any enactment and for the purpose of prudent management of its financial affairs.
- 9a.4 The Council defines its treasury management activities as the management of the Council's cash flows, its banking and money market transactions, the effective control of the risks associated with those activities, and the pursuit of best value performance consistent with those risks.

### **9b Policy**

- 9b.1 This strategy establishes formal objectives, policies and practices and reporting arrangements for the effective management and control of the Council's treasury management activities and the associated risks.

### **9c Investment Objectives**

- 9c.1 In accordance with Section 15 (1) of the Local Government Act 2003, the Council will have regard to (a) such guidance as the Secretary of State may issue and (b) such other guidance as the Secretary of State may by regulations specify.
- 9c.2 The Council's investment priorities are the security of its reserves, and the adequate liquidity of its investments, and the return on investment - the Council will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.
- 9c.3 All investments will be made in sterling.

- 9c.4 The Department for Communities and Local Government maintains the borrowing of money purely to invest or to lend and make a return is unlawful and the Council will not engage in such activity.
- 9c.5 Where external investment managers are used, they will be contractually required to comply with the Strategy.
- 9c.6 The Council will monitor the risk of loss on investments by review of credit ratings on a regular basis. The Council will only invest in institutions of high credit quality – based on information from credit rating agencies (as defined).

9c.7 Investments will be spread over different providers where appropriate to minimise risk.

#### **9d. Specified Investments**

- 9d.1 Specified investments are those offering high security and high liquidity, made in sterling and with a maturity of no more than a year. Such short-term investments made with the UK Government or a Local Authority (as defined) or a Town/Parish Council will automatically be Specified Investments.
- 9d.2 For the prudent management of its treasury balances, maintaining sufficient levels of security and liquidity, the Council will use deposits with banks, building societies, local authorities or other public authorities
- 9d.3 The choice of institution and length of deposit will be at the discretion of the Resources Committee and the RFO.

#### **9e Non- Specified Investments**

- 9e.1 These investments have greater potential risk – examples include investment in the money market, stocks, and shares.
- 9e.2 Given the unpredictability and uncertainty surrounding such investments the Council will not use this type of investment.

#### **9f. Liquidity of Investments**

- 9f.1 The Resources Committee in consultation with the Responsible Finance Officer will determine the maximum periods for which funds may prudently be committed so as not to compromise liquidity.
- 9f.2 Investments will be regarded as commencing on the date the commitment to invest is entered into rather than the date on which the funds are paid over to the counterparty.
- 9f.3 Where external grant funds are received the decision to place on term deposit should be aligned with the anticipated spend profile of the capital project involved and invested for no longer than 6 months or more than 25% of the individual project value .
- 9f.4 Where such investment on term deposit is made A schedule of investments relayed to anticipate capitols spend should be provided to the Resources Committee .

#### **9g Long Term Investments**

- 9g.1 Long term Investments are defined in the Guidance is greater than 36 months.
- 9g.2 The Council currently holds an investment of £3,000 with a Community Share Offer in respect of “Fielden Acre” where funds cannot be withdrawn in the first two years.
- 9g.3 No further long-term investments are envisaged during the financial year 2024/25

#### **9h Cash flow nature of investment opportunity**



- 9h.1 The Council receives its Annual Precept in one total amount in early April for each year.
- 9h.2 The nature of Earmarked Reserves is likely to involve a longer-term nature of call (sometimes over one year).
- 9h.3 Any borrowing for projects of a capital-based nature will be drawn down in one amount and may be drawn down ahead of capital expenditure being incurred.
- 9h.4 Considering these issues, it is proposed that a policy of investment is adopted as detailed in the following table: -

Cash flow type	Current availability	Immediate deposit account access	1 month term	3-month term	6-month term	9-month term	12-month term
Day to day bank current account	Maintain balance of £10,000	N/A	No	No	No	No	No
Day to day bank instant access deposit account	Maintain 3 months' overall need.	Yes	No	No	No	No	No
<b>Bank and or Building Society Investment Term Deposits</b>							
End of year General Reserve		50% of balance	50% of balance	No	No	No	No
Receipt of precept	Maintain two months' estimated need	50% of balance	No	No	Yes	No	No
Receipt of precept	Maintain two months' estimated need	25% of balance	No	No	Yes	No	No
Earmarked Reserves	Relative to Reserve	No	Yes	Yes	Yes	Yes	Yes
Capital Borrowing	Relative to call	100%	Yes	Yes	Yes	No	No

- 9h.5 In terms of daily use the availability of an immediate access deposit account will enable simple movement between bank current account and deposit account.

## **9i Delegated Powers**

- 9i.1 Within the scheme of delegation the RFO should be provided with delegated powers to move funds between current and instant access deposit account as required.
- 9i.2 Within the Scheme of Delegation the placement and movement of funds into and from term deposits should be delegated to the Chair of Resources Committee with the RFO.
- 9i.3 The decision to initially place funds into non – bank account Term deposits e.g. Building Societies should be made By Resources Committee under delegated powers from Full Council.
- 9i.4 At each Full Council meeting a breakdown of Investments held should be provided together with details of investment rates being achieved.

# Appendix 1

## STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS (3rd Edition)

Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1 April 2018

### POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. Under that section local authorities are required to “have regard” to “such guidance as the Secretary of State may issue”.

### DEFINITION OF TERMS

2. In this guidance the 2003 Act means the Local Government Act 2003.

3. Local authority has the meaning given in section 23 of the 2003 Act. To the extent that this guidance applies to parish councils and charter trustees (see paragraph 11) a reference to a local authority includes those councils and trustees.

4. The definition of an investment covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

5. For the avoidance of doubt, the definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party. The term does not include pension funds or trust fund investments, which are subject to separate regulatory regimes and therefore are not covered by this guidance.

6. A credit rating agency is one of the following three companies:

- Standard and Poor’s;
- Moody’s Investors Service Ltd; and
- Fitch Ratings Ltd.

7. For the purposes of this guidance a loan is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who promises to return it according to the terms of the agreement, normally with interest. This definition does not include a loan to another local authority, which is classified as a specified investment.

8. The Treasury Management Code means the statutory code of practice issued by CIPFA: “Treasury# Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition”.

9. The Prudential Code means the statutory code of practice, issued by CIPFA: “The Prudential Code for Capital Finance in Local Authorities, 2017 Edition”.

10. The Capital Strategy is the strategy required by the updates to the Prudential Code and Treasury Management Code.

### APPLICATION Effective date

11. This guidance applies for financial years commencing on or after 1 April 2018. It supersedes all previous editions of the Statutory Guidance on Local Authority Investments.

12. Strategies presented to Council or equivalent before 1 April 2018 but relating to 2018-19 and future financial years do not need to include all of the additional disclosures required by this edition of the guidance should it not prove practical or cost effective to do so. If a local authority chooses not to include the new disclosures in its 2018-19 Strategy, it must include the disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

### Local authorities

13. This guidance applies to all local authorities in England.

14. This guidance applies to parish councils and charter trustees, providing their total investments exceed or are expected to exceed £100,000 at any time during the financial year. Where a parish council or charter trustee expects its total investments to be between £10,000 and £100,000, it is encouraged to adopt the principles in this guidance.

## KEY PRINCIPLES

### Transparency and democratic accountability

15. For each financial year, a local authority should prepare at least one Investment Strategy (“the Strategy”). The Strategy should contain the disclosures and reporting requirements specified in this guidance.

16. The Strategy should be approved by the full council. For authorities without a full Council, the Strategy should be approved at the closest equivalent level. The Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

17. Where a local authority proposes to make a material change to its Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

18. The Strategy should be publicly available on a local authority’s website. Where a parish council or charter trustee does not maintain its own website, they should post a public notice detailing how local residents can obtain a copy of the Strategy, free of charge.

19. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Strategy can be published in those documents instead of in the Strategy.

### Contribution

20. Investments made by local authorities can be classified into one of two main categories:

- Investments held for treasury management purposes; and
- Other investments.

21. Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance.

22. Local authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority. It is for each local authority to define the types of contribution that investments can make and a single investment can make more than one type of contribution.

### Use of indicators

23. The Strategy should include quantitative indicators that allow Councillors and the public to assess a local authority’s total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return received. Where investment decisions are funded by borrowing the indicators used should reflect the additional debt servicing costs taken on.

24. Local authorities should consider the most appropriate indicators to use, given their risk appetite and capital and investment strategies. Whilst this guidance does not prescribe specific indicators or thresholds, the indicators used should be consistent from year to year and should be presented in a way that allows elected members and the general public to understand a local authorities’ total risk exposure from treasury management and other types of investment.

25. Where a local authority has entered into a long term investment or has taken out long term debt to finance an investment the indicators used should allow Councillors and the general public to assess the risks and opportunities of the investment over both its payback period and over the repayment period of any debt taken out.

Security, Liquidity and Yield

26. A prudent investment policy will have two underlying objectives:

- Security – protecting the capital sum invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed.

27. The generation of yield is distinct from these prudential objectives. However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these priorities.

28. When entering into treasury management investments, local authorities should consider security, liquidity and yield in that order of importance.

29. When entering into other types of investments local authorities should consider the balance between security, liquidity and yield based on their risk appetite and the contribution(s) of that investment activity.

#### Security Financial Investments

30. Financial investments can fall into one of three categories:

- Specified investments;
- Loans; and
- Other Non-specified investments.

#### Specified Investments

31. An investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling.
- The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a nonconditional option.
- The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].
- The investment is made with a body or in an investment scheme described as high quality (see paragraph 33 or with one of the following bodies: i. The United Kingdom Government; ii. A local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; or iii. A parish council or community council.

32. For the purposes of paragraph 32 the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 42 is relevant.

#### Loans

33. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

34. Local authorities can make such loans whilst continuing to have regard to this guidance if they can demonstrate in their Strategy that:

- Total financial exposure to these type of loans is proportionate;
- They have used an allowed “expected credit loss” model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 Financial Instruments as adopted by proper practices to measure the credit risk of their loan portfolio;
- They have appropriate credit control arrangements to recover overdue repayments in place; and
- The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

#### Non-specified investments

35. A non-specified investment is any financial investment that is not a loan and does not meet the criteria to be treated as a specified investment.

36. For non-specified investments (i.e. those not meeting the criteria in paragraph 31), the Strategy should:

- Set out procedures for determining which categories of investments may be prudently used (and where these procedures involve the use of credit ratings, paragraph 32 is relevant).
- Identify which categories of investments have been defined as suitable for use.
- State the upper limits for the maximum amounts both individually and cumulatively that may be held in each identified category and for the overall amount held in non-specified investments and confirm that investments made have remained within those limits.

#### Non-financial investments

37. As defined in paragraph 4 of this guidance non-financial investments are nonfinancial assets that the organisation holds primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.

38. Where the fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

39. Where the fair value of non-financial investments is no longer sufficient to provide security against loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

40. Where a local authority recognises a loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

#### Risk Assessment

41. The Strategy should state the local authority's approach to assessing risk of loss before entering into and whilst holding an investment, making clear in particular:

- How it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements.
- Whether and, if so how, a local authority uses external advisors be they treasury management advisors, property investment advisors or any other relevant persons.
- How the local authority monitors and maintains the quality of advice provided by external advisors.
- To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies.
- Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.
- What other sources of information are used to assess and monitor risk.

#### Liquidity

42. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed and state what those maximum periods are and how the local authority will stay within its stated investment limits.

43. For non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at a portfolio level if appropriate.

44 Proportionality. Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery

objectives and/or place making role of that local authority is dependent on achieving the expected net profit. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net profit.

45. The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

#### Borrowing in advance of need

46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:

- Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and
- The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

#### Capacity, skills and culture

48. The Strategy should disclose the steps taken to ensure that those elected members and statutory officers involved in the investments decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment, to assess individual assessments in the context of the strategic objectives and risk profile of the local authority and to enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

49. The Strategy should disclose the steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

50. Where appropriate the Strategy should comment on the corporate governance arrangements that have been put in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

## ANNEX A – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Power under which this Guidance is issued [paragraph 1] 1. The Local Government Act 2003, section 15(1), requires a local authority "...to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify...".

2. The guidance on investments in the main part of this document is issued under section 15(1) of the 2003 Act and authorities are therefore required to have regard to it. This part (Annex A) contains an informal commentary ("the commentary") on the Statutory Guidance.

3. Two codes of practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) contain investment guidance which complements the MHCLG guidance. These publications are:

- Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes
- The Prudential Code for Capital Finance in Local Authorities

4. Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] as amended.

Objectives in updating the Guidance 5. The 2nd edition of this Guidance, which was issued in 2010, reflected concerns raised by the CLG and Treasury Select committees as part of their enquiries into the financial crash of 2007-8. The key areas of focus were:

- The practice of investing for yield, especially in Icelandic Banks;
- The need for transparent investment strategies; and
- The use of Treasury Management advisors.

6. The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

7. In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

- Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
- There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and
- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

Effective Date [paragraphs 11-12]

8. This Guidance applies from 1 April 2018. It supersedes all previous editions of the Guidance.

9. The Guidance requires local authorities to produce a number of additional disclosures. Many local authorities already produce these as part of internal reporting and risk management procedures. However, if these disclosures are not currently produced, then local authorities do not need to prepare them in full for Strategies presented to full Council or equivalent before 1 April 2018. Those local authorities who do not include the required disclosures in their 2018-19 strategies, should present them for approval the first time the relevant Strategy is updated or superseded. Local Authorities [paragraphs 12-13]

10. This Guidance applies to all local authorities, who hold or during the next financial year intend to hold financial or non-financial investments, solely or in part to generate revenue income.

11. It applies to parish councils whose investments exceed the thresholds set out in paragraph 14. The decision to lower the financial threshold for parish councils has been taken in recognition that some parishes have begun to engage in commercial ventures. As parish councils tend to be fairly small and to obtain a greater percentage of their funding directly from council tax payers than other types of local authority, it is right that they demonstrate that they have carefully considered the expertise that they need to manage the risks arising from their strategy. Transparency and democratic accountability [paragraphs 15-19]

12. The Government believes that local authorities need to be better at explaining “why” not just “what” they are doing with their investment activity. That means that the sector needs to demonstrate more transparency and openness and to make it easier for informed observers to understand how good governance and democratic accountability have been exercised.

13. The additional disclosures required by the Guidance should be included in a single document presented to full Council or the equivalent. Although the Guidance refers to an Investment Strategy, providing that all of the disclosures are easy for interested parties to find and are in or linked from a single document, a separate Strategy does not need to be prepared. The Strategy should be updated at least annually.

14. Subject to the provisions in paragraph 35 and 36 of the commentary, local authorities can exclude specific non-financial investments from the required disclosures on grounds of commercial confidentiality. The Government expects that non-disclosure on grounds of commercial confidentiality will be an exceptional circumstance. A local authority should only determine that it would breach commercial confidentiality to include an investment in the disclosures on receipt of appropriate professional advice, using the same criteria as would be used to exclude the public from a Council meeting. Local authorities should reassess whether the commercial confidentiality test is met every time a new Strategy is presented to full Council or the equivalent.

15. Under Regulation 17 of the The Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 as amended overview and scrutiny committee members have right of access to any confidential information relating to any decision by any committee or any member of the executive of their council. Nothing in this Guidance has the power to override this regulation.

16. Assets that generate revenue income solely through fees and charges for discretionary services levied under Section 93 of the Local Government Act 2003 should not be classified as non-financial investments for this purpose.

17. If disclosures are already produced in another document that is publicly available then a local authority can provide a link to the disclosures from the Strategy rather than reproducing them. The exception is disclosures contained in the Statutory Accounts, which do not meet the requirements of this Strategy. This is because local authority statutory accounts can be complex and difficult for users who are not familiar with local government accounting to understand and statutory accounts are prepared to a higher level of materiality than local authorities should use for internal risk management.

#### Contribution [paragraphs 20-22]

18. Local authorities may have several different objectives, when deciding to acquire an asset. If an asset is not solely held for yield, then a local authority may have a different risk appetite or be willing to accept a lower return than it otherwise would.

19. Each local authority should determine how it categorises different types of contribution, and each investment can have more than one type of contribution. A non-exhaustive list of types of contribution include:

- Yield/profit
- Regeneration
- Economic benefit/business rates growth
- Responding to local market failure
- Treasury management

20. Where a local authority classifies an investment as contributing to regeneration or local economic benefit, it should be able to demonstrate that the investment forms part of a project in its Local Plan.

#### Use of indicators [paragraphs 23-25]

21. Local authorities should present a range of indicators to allow members and other interested parties to understand the total exposure from borrowing and investment decisions. The indicators should cover both the local authority's current position and the expected position assuming all planned investments for the following year are completed. The indicators do not need to take account of Treasury Management investments unless these are expected to be held for more than 12 months.

22. The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. We recommend that, the indicators in the table below are used. Where local authorities have a different risk appetite or different expectation of returns depending on the contribution(s) each type of investment makes, they should consider presenting the indicators, classified by type of contribution or risk appetite.

#### Debt to net service expenditure (NSE) ratio

Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.

#### Commercial income to NSE ratio

Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.

#### Investment cover ratio

The total net income from property investments, compared to the interest expense.

#### Loan to value ratio

The amount of debt compared to the total asset value. Target income returns Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties. Benchmarking of returns As a measure against other investments and against other council's property portfolios.

#### Gross and net income

The income received from the investment portfolio at a gross level and net level (less costs) over Time



## Operating costs

The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.

## Vacancy levels and Tenant exposures for nonfinancial investments

Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.

23. Where appropriate, local authorities should consider including targets or limits set by members alongside the outturn. Where there has been a significant change in year on year performance against any of the indicators presented local authorities should include an explanation in the Strategy.

24. Local authorities can choose to present additional indicators in the Strategy should they believe that it would enhance understandability and transparency to do so.

## Security, liquidity and yield [paragraphs 26-29]

25. For treasury management and other financial investments local authorities should continue to prioritise SECURITY, LIQUIDITY and YIELD in that order of importance.

26. Whilst consideration of security and liquidity is important for loans and nonfinancial investments, the relative balance between objectives may be different depending on the nature and objectives in making a specific investment.

## Security and liquidity Loans [paragraphs 33 – 34, 40]

27. Loans to joint ventures, local SMEs or third sector bodies, and wholly owned companies fall within the scope of the Guidance. When considering security and liquidity of loans local authorities should set limits for their total exposure and apply the expected loss model in line with the requirements of IFRS 9 Financial Instruments.

## Non-financial investments [paragraphs 37-40, 43]

28. Where a local authority has a non-financial investment, it will have an asset that can be realised to recoup the sums invested. Therefore, the Guidance requires local authorities to consider security by reference to the value of the asset relative to purchase price and to set out the plans to recoup the investment if realising the asset would not recoup the sums invested. In the period immediately after purchase, it is normal for the directly attributable costs of purchasing a nonfinancial investment to be greater than the realisable value of the asset. In this scenario, all the Strategy needs to disclose is how long the local authority expects it to take for the increase in asset values to provide security for the sums invested and the assumptions underpinning that expectation.

29. Non-financial investments are by their nature illiquid. However, this does not mean that the local authority does not need to plan for realising a part of its nonfinancial investment portfolio, for example to repay debt. The liquidity of the nonfinancial investment portfolio should be considered over the repayment period of any debt taken out to acquire assets, which could be very long term. Given current trends such as the scale and pace of technology driven change, there is no guarantee that non-financial investments will continue to deliver value over their lifetime. To manage this risk, local authorities need to have plans to realise the capital tied up in non-financial investments if required. In addition, the Strategy should consider the trade-offs between accepting capital loss and refinancing debt incurring additional debt servicing costs by doing so, if appropriate.

## Proportionality [paragraphs 44-45]

30. Local authorities need to consider the long term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure.

31. In addition, whilst under statute, local authority debt is secured on the revenues of that authority, in practice, there is no realistic prospect of the revenues of any local authority being sufficient to pay back debt equating to many multiples of the sum of NNDR and Council Tax Income, without a

pervasive and long term impact on service delivery. It is unclear whether local authorities who have adopted a debt financed commercial investment strategy have realistic plans to manage failure. Whilst the Government recognises the importance of local authorities taking on debt to enhance service provision, irrespective of the source of finance, it does not believe that it should do the same for commercial investments.

32. For this reason, the Guidance introduces a new requirement that in every local authority, full council or its nearest equivalent, sets limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure.

33. If a local authority has exceeded these limits through investments taken out prior to the introduction of this Guidance, it does not need to dispose of investments currently held. However, authorities who have exceeded their self-assessed limits should not enter into any further investments, irrespective of how these are financed, other than short term investments required for efficient treasury management.

#### Borrowing in advance of need [paragraphs 46-47]

34. The Prudential Code, issued by CIPFA has always contained a statement that local authorities should not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The purpose of repeating that statement in this Guidance is to make it clear that it extends to borrowing taken on to finance the acquisition of non-financial as well as financial investments.

35. Local authorities can still finance the acquisition of financial on non financial investments from capital receipts generated from the sale of surplus assets. However, they should not repurpose receipts allocated to the acquisition of assets that contribute to service delivery to fund the purchase of investments, solely to avoid the requirements against borrowing in advance of need.

36. If exceptionally a local authority, chooses not to have regard to the provision on borrowing to fund investment activity the Guidance requires them to explain, in their Strategy, the rationale for this decision.

37. The purpose of this disclosure is to allow external auditors, tax payers and other interested parties to understand why the local authority has chosen to disregard the Guidance, and to hold the authority to account should they believe there is not sufficient reason for doing so.

#### Capacity, Skills and Culture [paragraphs 48-50]

38. In the Public Accounts Committee report of 18 November 2016<sup>1</sup>, members raised concerns that, locally elected members may not always have the background and expertise to understand the risks associated with the decisions that they are being asked to make. For this reason the Guidance extends the requirements on capacity and skills to members and any statutory officers involved in or responsible for signing off on investment decisions.

39. Members do not necessarily need formal training in understanding investment risks to satisfy the requirements of the Guidance. Depending on their level of expertise a presentation setting out the risks and opportunities of an investment strategy/specific investment in terms a layman would understand, may be sufficient to meet the new requirements.

40. The Government is aware that many local authorities have brought in outside expertise to identify and negotiate investment opportunities. Whilst this can be an effective method of risk management, it is important that those negotiating deals understand that they are not operating in a purely commercial environment and that the prime purpose of a local authority is to deliver statutory services to local residents. Therefore, the Strategy should comment on how they have been made aware of this.