

## GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

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 to generate financial returns, such as 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 specific investment.
8. The **Capital Strategy** is the strategy required by the proposed update to the *Prudential Code* and *Treasury Management Code*, produced by CIPFA.

## **APPLICATION**

### **Effective date**

9. This guidance applies for financial years commencing on or after 1 April 2018. This includes strategies relating to those years, but presented for approval prior to 1 April 2018.

### **Local authorities**

10. This guidance applies to all local authorities in England.
11. 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**

12. For each financial year, a local authority should prepare at least one Investment Strategy ("the Strategy").
13. 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.
14. Where a local authority proposes to make a material change to its investment strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.
15. 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.
16. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, the matters required to be disclosed in the Strategy can be incorporated in that document.

### **Contribution**

17. The core function of a local authority is to deliver statutory services to local residents. Where a local authority chooses to invest in non-core activities and

investments, it should disclose in its Capital Strategy the financial contribution that the activity or investment will make towards the delivery of core functions.

### **Use of indicators**

18. 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 invests 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.
19. 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 Councillors and the general public to compare a local authority's investment decisions to a similar authority, should they wish to do so.
20. 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**

21. 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.
22. 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.

### **Security**

#### Financial Investments

23. Financial investments can fall into one of three categories:
  - **Specified investments;**
  - **Loans;** and
  - Other **Non-specified investments.**

## Specified Investments

24. 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 non-conditional 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 25); 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.

25. For the purposes of paragraph 24, the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 35 is relevant.

## Loans

26. A local authority may choose to make loans to local enterprises 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.

27. 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 expected loss model to assess the impact on their balanced budget requirements if the capital loaned is at risk;
- 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

28. 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.

29. For non-specified investments (i.e. those not meeting the definition in paragraph 23), 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 33 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

30. 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*.

31. 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.

32. 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.

33. Where a local authority has to impair a non-financial asset held for investment purposes 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 impairment on the security of investments and any revenue consequences arising therefrom.

#### Risk Assessment

34. 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**

35. For financial investments and 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.
36. 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.

## **Proportionality**

37. Where a local authority is or plans to become dependent on yield bearing investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the core functions of the local authority is dependent on achieving the expected net yield. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net yield.
38. Where a local authority has funded investment activity through prudential borrowing, the Strategy should detail the opportunity costs of using that borrowing capacity for investment rather than service delivery activity. This disclosure should cover both borrowing to fund a specific investment and the cumulative borrowing capacity allocated for this purpose.
39. The assessment of dependence on yield bearing investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Mid Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

## **Borrowing in advance of need**

40. Borrowing solely to invest in a yield bearing opportunity is borrowing in advance of need.
41. Where a local authority borrows to invest in a yield bearing opportunity the Strategy should explain:
- Why the local authority has decided to borrow in advance of need 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 yield or borrowing costs increasing.

## **Capacity, skills and culture**

42. The Strategy should disclose the steps taken to ensure that Councillors and statutory officers 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.
43. 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.
44. 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.