DCN
DISTRICT COUNCILS' NETWORK
BETTER LIVES – STRONGER ECONOMIES

Local Government capital risk mitigation measures in the Levelling Up and Regeneration Bill: capital risk metrics

District Councils' Network consultation response

September 2023

About the District Councils' Network

The District Councils' Network (DCN) is a cross-party network of 163 district councils and 5 unitary councils. We are a special interest group of the Local Government Association, providing a single voice for all district services.

DCN member councils deliver a wide range of local government services to over 21 million people – 38% of England's population. They cover 60% of the country by area. DCN councils are home to 38% of England's businesses and produce 33% of national Gross Domestic Product.

Executive Summary

This response has been drafted in collaboration with colleagues at the Society of District Council Treasurers (SDCT).

Our detailed response includes our views on the specific risk metrics. In addition, DCN has overarching views about how these metrics will be used by central government and how they fit together as a set of metrics. In particular, we have significant concerns that these metrics could be used as a way of ranking councils according to the level of debt they currently hold or the types of investments they have historically made. These indicators, whilst potentially useful to identify certain outlier councils, do not tell the full story and may not always accurately indicate whether any given council is in a detrimental position. In the DCN's view, a council investment portfolio could be very well supported and diversified yet still fall foul of these metrics. It is vital that these metrics are used carefully and in conjunction with other information.

The clear majority of district councils (and indeed all local authorities) have borrowed and invested responsibly to support their ongoing spending. It is key that councils do not see their ability to support their services unduly curtailed as a result of these risk metrics. This is especially important for district councils. That is because districts receive a much lower proportion of their funding from central government grant than other types of council. As a result, they rely on their ability to raise income locally to balance their budgets and to invest in important local and national priorities.

Our members tell us that the growing curtailment of the investment freedoms first introduced in 2010 now denies them the ability to generate income from making prudent commercial investments – in some case quite significantly. The DCN believes it is important that the risk ratios do not compound this problem.

We are also concerned that all of these metrics will only identify risk from historical investments decisions. If one of the Government's aims is to identify areas of future risk, these metrics will not do so, certainly not unless accompanied by other information.

We would also welcome further guidance from central government about how these metrics will interact with the government's Statutory Guidance on Local Authority investment.

Detailed response

Risk Metric 1 - total of a local authority's debt as compared to the financial resources at the disposal of the authority. This is intended to identify authorities carrying a disproportionate level of debt, in excess of its resources, thus presenting an excessive level of risk to sustainability.

1(a) Capital Finance Requirement / **Total Service Expenditure (NSE)**	Capital Finance Requirement is taken as the most appropriate measure of debt and divided by Total Service Expenditure as the most appropriate measure of an authority's size. The output of the calculation provides a metric that gives an authority's level of debt relative to its size. It gives a simple means to identify those authorities that are outliers with respect to disproportionate levels of debt.

1. **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation should be the basis for this metric?**

No.

The use of this metric is not unhelpful in acting as a lens to identify outlier councils whose position can be explored further. However, it should be recognised that there may be legitimate reasons why a council generates a high score on this metric.

In some respects, Total Service Expenditure (TSE) is a good measure of the size of a local authority because it is based on actual spending figures.

However, importantly, it excludes Housing Revenue Account (HRA) expenditure. By contrast, Capital Finance Requirement (CFR) includes HRA debt. To be meaningful and legitimate, the HRA element of CFR should be excluded from both the denominator and the numerator.

Otherwise the ratio will produce very misleading outputs, especially between councils with an HRA and those without. This is very likely to lead to inaccurate conclusions and inappropriate comparisons. For example, some district councils have almost no General Fund debt but may have significant levels of HRA debt. That debt will be serviced from income arising in the HRA.

As proposed, the metric will miss this point and may give rise to the misleading conclusion that a council has an unsustainably high level of debt relative to its size. There is no good reason in principle why HRA expenditure should be included in the numerator for this metric. If there is a practical objection that the data is not currently available to allow HRA debt to be separated out, the onus should be on DLUHC to work with local government to produce the data.

We have heard concerns from stock-holding councils that this metric, alongside the metrics being used by the Office for Local Government, must not conflate any debt relating to their HRA with general fund CFR. This is key so that councils are not treated as overly indebted compared to statistical neighbours who do not own social housing.

The inclusion of HRA figures is an obvious flaw in the metric and needs to be corrected.

Additionally, the limitations of the metric include not being able to distinguish between authorities with a similar CFR but where one has relatively high levels of reserves and balances and may not need to externalise internal borrowing and another that does not. Therefore, this measure will likely inadvertently identify a LA that manages its overall treasury management position well and is not a high risk as being the opposite.

2. **Are any of the alternative calculations more appropriate than the proposed calculation?**

No – as set out above.

3. **Considering the objectives set out in this document, and the principles set out, is there an alternative calculation/s you think is more appropriate?**

Yes – as outlined above we would support an alternative or additional metric which treats HRA debt and expenditure consistently.

Risk Metric 2 - proportion of the total of a local authority's capital assets which is investments made, or held, wholly or mainly in order to generate financial return. This is intended to identify authorities exposed to risk due to incurred capital expenditure primarily or only for a financial return, rather than meeting service needs or priorities.

2(a) Investment income /Total Service Expenditure	Non-treasury management investment income, taken from the annual revenue returns, divided by TSE. This calculation should identify where authorities have very high levels of investment income relative to size.

1. **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation should be the basis for this metric?**

Yes, but with modifications.

The definition of this metric needs to be clarified. It is unclear whether the intention is to reflect investments that are 'made, or held, wholly or mainly in order to generate a financial return' (commercial) or to show the return for all non-treasury investments including both service and commercial as defined by the CIPFA Treasury Management Code. If this metric is designed to capture all non-treasury investments, then the proposed calculation is our preferred option.

However, 2a does not show the level of commercial capital assets, only the income from them. If there is no income generated, for example because they are loss-making or interest payments on loans are to be deferred, this will not highlight authorities that may have a high proportion of commercial risk.

It would also be incorrect to include in these calculations any investments previously made but which are not currently subject to any borrowing i.e. because the debt has been fully repaid. Where councils own an asset outright, it would not meet the purpose of the metric to include income from this in any calculation as this does not constitute the same risk.

2. **Are any of the alternative calculations more appropriate than the proposed calculation?**

No – as set out above.

3. **Considering the objectives set out in this document, and the principles set out, is there an alternative calculation/s you think is more appropriate?**

Yes – as set out above.

Risk Metric 3: proportion of the total of a local authority's debt (including credit arrangements) in relation to which the counterparty is not central government or a local authority. The purpose of this metric is to capture any risk from the source and nature of the debt incurred by the local authority. This will therefore capture the extent and cost of counterparty debts, including credit arrangements, with non-government partners. This is not intended to dissuade local authorities from all non-government lending.

3(a) Non-government debt / Total borrowing	This calculation simply uses total external borrowing, taken from the annual capital returns (gross borrowing + other long-term liabilities), less borrowing from PWLB + central government + local government (from quarterly borrowing and investment live tables) and divided by total external borrowing. This gives the proportion of debt where the counterparty is not central or local government.

1. **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation should be the basis for this metric?**

Yes.

This metric is not unhelpful in acting as a lens to identify outlier councils whose position can be explored further. However it should be recognised that there may be legitimate reasons why a council has a high ratio of non-government debt. This metric should not be looked at in isolation.

This is important because this metric will likely flag historical decisions, rather than prevent imprudent decisions being taken in future. If the intention of these risk metrics is to prevent novel or high-risk future arrangements, this metric will not achieve that aim in isolation.

2. **Are any of the alternative calculations more appropriate than the proposed calculation?**

No – as set out above.

3. **Considering the objectives set out in this document, and the principles set out, is there an alternative calculation/s you think is more appropriate? YES/NO Please explain**

No – as set out above.

Risk metric 4: amount of Minimum Revenue Provision (MRP) charged by a local authority to a revenue account for a financial year. This metric is designed to ensure that councils are not under-charging MRP, which is a risk to local taxpayers and the authority itself. The consultation indicates that, further to recommendations from the Public Accounts Committee, there will be a further consultation on updated MRP guidance in due course.

4(a) Reported MRP/ CFR (less CFR for the Housing Revenue Account):	MRP is taken from either the annual revenue return or from the capital return for a specific financial period and divided by the CFR as at the start of that financial period. The purpose of this metric is to show the MRP charge as a proportion of the CFR. As MRP is charged on CFR, this should highlight outliers where the amount of MRP relative to debt is below what would be expected if an authority were fully complying with the statutory guidance.

1. **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation should be the basis for this metric?**

Yes, but with modifications.

We believe this metric should not be viewed in isolation because it may not fully capture all the factors that might identify authorities that are not making sufficient MRP e.g. impending impairment of an asset or a loan to a third party.

Additionally, the proposed calculation is based on only one year. This metric is unlikely to identify a potential issue which may be disguised through in-year one-off movements in the MRP charges.

2. **Are any of the alternative calculations more appropriate than the proposed calculation?**

No – as set out above.

3. **Considering the objectives set out in this document, and the principles set out, is there an alternative calculation/s you think is more appropriate?**

Yes - we would support an alternative or additional metric which factors in calculations covering more than one year and/or in-year movements.