Room 151
Local Government Treasury, Technical & Strategic Finance

DCLG faces calls to clarify guidance over borrowing for property investment

By Colin Marrs, 23 November 2017

Experts are calling for greater clarity over proposed guidance governing council borrowing to fund investment in property after an expected budget crackdown failed to materialise.

Sources close to the issue predicted that the Treasury would take action to prevent authorities using Public Works Loan Board (PWLB) borrowing to buy out-of-borough property.

But no announcement was forthcoming, leaving some in the sector scratching their heads over the impact of a Department for Communities' consultation about changes to the investment code, released the previous week.

Last week, the *Local Government Chronicle* reported comments made by CIPFA director of local government, Sean Nolan, that the consultation's provisions on "borrowing in advance of need" would make such borrowing "near impossible".

The DCLG consultation document said: "Borrowing solely to invest rather than to deliver statutory services, or strategic objectives, has always been considered to be borrowing in advance of need.

"The government believes that it is appropriate for the revised guidance that recognises (sic) this and requires additional disclosure by local authorities who borrow solely to invest in revenue generating investments."

Clarification call

However, David Green, client director at treasury adviser Arlingclose, said that this wording amounted to a call for councils to provide greater transparency, rather than a ban.

He said: "The existing guidance from CIPFA, DCLG and the PWLB each discusses how local authorities should handle borrowing in advance, something they are hardly likely to do if it is banned."

Stephen Sheen, managing director of technical accounting consultancy Ichabod's Industries, said: "Borrowing in advance of need has always been a legitimate treasury management tool, albeit with some inherent risk, to plan for a future cash requirement. It is not outlawed, and neither will it be by the proposed changes to the statutory guidance on investments.

"All the proposed amendment to the guidance is saying is that borrowing for a purpose other than to facilitate the provision of services is borrowing in advance of need, on the basis that the expenditure did not actually need to take place."

However, another senior figure in the sector, who did not want to be named, said that when the investment guidance is read together with proposed changes to CIPFA's prudential code, then it would, in fact, prevent councils from borrowing to invest outside their own boundaries.

The proposed wording, as yet to be adopted, says: "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."

But Green and others argue that the prudential code is generally taken to refer to treasury investments rather than property assets.

Chris Shepherd, director at public sector finance consultancy 31ten, said that further clarification would be needed on the issue if the government's intention is to prevent councils from borrowing from the PWLB to fund property purchases.

"The key will be whether they will define yield bearing asset as a financial instrument or as an asset.

"The implications of the latter could mean investing in or out-of-borough would be difficult (without an argument for investing for other reasons)."

Wording confusion

Experts also said that the wording used in the DCLG consultation document muddled up two distinct strands of investment. Green said: "It's odd that DCLG is confusing borrowing in advance with borrowing to invest.

"These are widely accepted as two different concepts: borrowing in advance involves a temporary investment of the borrowed funds until the planned capital expenditure is incurred; with borrowing to invest, the investment is the capital expenditure."

Sheen said: "The DCLG consultation uses 'borrowing in advance of need' to describe what is effectively on-lending."

Shepherd added: "I think this will need to be fleshed out more.

"Councils have been borrowing to invest in investment properties for years and this has never been classed as investing in advance of need.

"Borrowing in advance of need was brought to light when local authorities were borrowing from PWLB at say 4% and investing this in financial instruments such as the Icelandic Banks.

"This to me feels wrong, but at the same time significantly different from investing in an investment property."

The DCLG, when approached by Room151, was unable to answer specific questions on confusion over the wording of its guidance.

However, in a statement, it reiterated that borrowing to invest in a revenue generating opportunity will be classed as borrowing in advance of need.

It said: "If a council chooses to borrow for an investment purely to generate revenue, then our proposals will require them to explain why they have chosen not to follow the statutory guidance.

"The intention of the guidance is to make it clear that government does not believe that it is appropriate for local authorities to borrow for the sole purpose of generating revenue income."

The statement did not mention the relationship between the proposed changes to the investment code and prudential code.

Room151 approached CIPFA for a comment but nobody was available by the time of publication.