Department for Levelling Up, Housing & Communities

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

Body/bodies responsible for the consultation:

Department of Levelling Up, Housing and Communities

Duration:

This consultation will last for 10 weeks from 13th July 2023 until 21st September 2023

Enquiries:

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Summary

1. The Department for Levelling Up, Housing and Communities ("the Department") has policy responsibility for the Prudential Framework ("the Framework") under which local authorities borrow and invest, and stewardship responsibility to ensure that the system is operating effectively. The objective of the Framework is to ensure that borrowing and investment practices are prudent, sustainable and affordable, while providing authorities the freedom to set their own capital strategies. The government carefully monitors sector risk and regularly reviews whether the Framework remains fit for purpose.
2. The Framework has been in place since 2004 and has worked well in the main. However, it is evident that a minority of authorities have taken on excessive risk through their capital strategies, which in some cases has led to severe and pervasive financial failure requiring the government's intervention and support. The government has made changes to strengthen the capital system, and evidence indicates this has had a positive impact in reducing risk but recent financial failures have reiterated the importance of appropriate powers to address excessive risk in specific cases.
3. In May 2022, the government introduced The Levelling Up and Regeneration Bill ("the LUR Bill"), which includes new provisions with respect to council borrowing and investing. These expand the government's statutory powers to directly tackle excessive risk within the local government capital system. This seeks to safeguard the Framework and its principle of local decision making and accountability, by providing the means to address directly instances of problematic practices rather than using systemic reform that affects all authorities. Authorities operating without taking excessive risk will be unaffected, but risk to the overall system should be reduced, allowing authorities to deliver the capital investment needed in a way that is financially sustainable both now and in the future.
4. A local authority comes into scope of the new powers where a 'trigger point' is breached with respect to risk metrics, set out as part of the proposed measures in the LUR Bill. It has, however, always been government's intent that the specific methods of calculation of these metrics will be set out in regulations. This is to ensure that the metrics can be amended in a timely way to respond to changes in local government risk, incorporate new/more appropriate data or otherwise be adapted as needed to remain optimally effective. The government has been clear that it considers it important to engage with local authorities on the calculation methods and in making the regulations.
5. The Office for Local Government (OfLoG) Data Explorer includes a set of contextual financial metrics. These are separate to the metrics being considered in this consultation. Once determined, OfLoG will consider whether the metrics in the consultation should be incorporated into the Data Explorer for transparency purposes.

6. The government is now carefully considering the available options for the calculation methods for each of the metrics. It is the aim of this consultation to collect the views of authorities, sector representatives and relevant stakeholders with respect to the calculations of the metrics. This consultation is one part of the government's planned engagement. There will also be a series of sector roundtables and other opportunities for stakeholders to engage.

Background

7. The Framework comprises legislation that local authorities must adhere to and statutory codes, which they must have regard to. It provides wide freedoms for local authorities to borrow and invest without the need for specific consent from the government. In this way, the Framework supports local decision-making and accountability, allowing authorities to set their own capital strategies on the premise they are best able to understand and respond to local need and manage their own finances. Powers to borrow and invest are set out in sections 1 and 12 of the Local Government Act 2003 (the 2003 Act) respectively. The powers use common language that authorities may borrow/invest "for any purpose relevant to its functions under any enactment" or "for the purposes of the prudent management of its financial affairs". With respect to borrowing, authorities have a duty to determine and keep under review an affordable borrowing limit, which may not be exceeded.

8. Further guidance on best practice is set out in four statutory codes. The Department is responsible for preparing the Codes on making investment decisions (*Guidance on Local Government Investments*) and on calculating the annual amount of revenue to set aside to repay debt (*Guidance on Minimum Revenue Provision*). The Chartered Institute of Public Finance and Accountancy (CIPFA) produce the other two Codes that provide guidance on treasury management practices (*Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*) and on setting prudent, affordable capital strategies (*The Prudential Code for Capital Finance in Local Authorities* or "Prudential Code").

9. The government believes that most authorities are using the freedoms afforded by the Framework in line with its intentions and recognises the importance of local government investment for priorities such as levelling up, regeneration and housing provision. The government does not typically intercede in local decision making. The government does, however, have responsibility for stewardship of the financial system, which includes monitoring sector activity to identify new risks and updating the Framework to ensure it remains fit for purpose.

10. In recent years, the government has responded to trends, whereby a minority of authorities have taken on very high levels of debt, in some cases to invest in commercial assets where the primary objective is profit. The risks of such disproportionate borrowing and commercial investment were highlighted in the National Audit Office ("NAO") report *Financial sustainability of local authorities: capital expenditure and resourcing* in 2016 and again in 2020, *Local authority investment in commercial property*. Concerns predominantly focussed on investments in non-financial assets (commercial property). The subsequent Public Accounts Committee ("PAC") reports in 2016 and 2022 made recommendations for the government to strengthen the capital system.

11. In response, the government has taken a range of actions, starting with updating its statutory investment guidance in 2018 (see above) to strengthen the safeguards on commercial investments and proportionality of debt. Similarly, reforms to the Public Works Loan Board ("PWLB") from November 2020, prevent authorities investing primarily for yield, though borrowing remains available for permitted activities. Changes to CIPFA's Prudential Code (2021 edition) include further guidance on commercial investment, and have made it clearer that authorities should not be investing primarily for profit. The government has continually reiterated its message that authorities should not be borrowing to invest for commercial income and has been clear that it continues to monitor sector behaviour and will take further actions as needed.

12. Until comparatively recently (pre-2020), there were few instances of financial failure due to capital practices, and the NAO and PAC reports discussed *risks* rather than *issues* that had materialised. Since then, there have been a number of cases of local authority failure that demonstrate the scale of financial difficulty that can arise when excessive risk is taken with investment and borrowing, and the burdens this can place on authorities, those they serve and public funds.

13. The government's understanding of how risks can arise from capital practices has been significantly increased by the evidence from these cases of financial failures. While authorities taking on disproportionate levels of debt for commercial investment remains a driver of risk, other practices have contributed to the problems seen. These include the pursuit of novel and risky strategies, particularly in sectors outside a council's normal experience and scope of expertise; disproportionate debt, even where this is for activities that are not strictly for commercial investment; over-reliance on commercial income; and a failure of local processes to adequately manage risk. In July 2021, the government published its capital strategy that sets out a broader range of measures to strengthen the capital system.

14. The government has identified the need for a broader range of flexible powers to allow it to identify, investigate and mandate remedial action where excessive risk is identified. Measures taken by the government to date are mostly systemic and affect all local authorities to some extent. This reflects the fact that there are few appropriate statutory powers for the government to tackle instances of problematic capital practices *directly*. While the government can intervene using the Best Value powers, these are not always appropriate for addressing specific capital risks, particularly where issues have not yet manifested, yet the evidence shows that where issues arise these are often the consequence of actions taken years ago. Addressing risk before the point of failure is a more optimal outcome for the sector and public funds.

15. We have seen recent examples of very significant issues that require government support and place a financial burden on taxpayers, both locally and nationally. Without the ability for the government to take timely, targeted action, there is the possibility that issues seen in a minority of cases would require further reforms to the whole system. It is anticipated that the powers to tackle individual practices directly should serve to protect the current system, by allowing a targeted approach as opposed to widescale reform.

New statutory powers and risk metrics

16. In May 2022, government introduced the LUR Bill , which included capital measures. These measures provide a flexible range of interventions for the government to investigate and remediate extreme risk, which relate to a local authority's investment and borrowing. The proposed powers will provide government with the flexibility to intercede where it is appropriate to do so based on the government's assessment of risk. HM Treasury also issued an update to the Public Works Loan Board lending guidance, addressing lending to authorities where there is a more than negligible risk of non-repayment.

17. As set out in the LUR Bill, the ability to use the powers is triggered once authorities have breached specific measures of capital risk ("risk metrics") or where there are indications of financial failure through the issuance of a Section 114 notice, or where government support is required to avoid the need for a section 114 notice. It is important to recognise that where an authority comes within scope of the powers, the government will have a power *but not a duty* to take action. Action will be taken only where it is determined appropriate to do so. In determining risk, the government recognises that there is no one-size-fits-all approach, and the individual circumstances of each local authority must be taken into account.

18. Risk is defined in the LUR Bill as financial risk. That is, the risk that an authority will not be financially sustainable as a consequence of investing or borrowing practices. This is not to say other forms of financial risk cannot also be present or that risks to governance, service delivery and other aspects of a local authority are not considered by the government in its stewardship role. However, the objectives of the metrics are to determine where there is excessive financial risk.

19. The LUR Bill sets out four risk metrics, but the detailed methods of calculation are to be included in regulations, reflecting the fact that specific risks evolve and emerge, and it is right that powers that safeguard the Framework are also able to adapt in a timely way. So that the intentions for the risk metrics are clear, they are included in the LUR Bill:

    i. The total of a local authority's debt (including credit arrangements) as compared to the financial resources at the disposal of the authority.

    ii. The 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.

    iii. The 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.

    iv. The amount of minimum revenue provision charged by a local authority to a revenue account for a financial year.

20. The metrics are based on the body of accumulated evidence on the behaviours that are driving capital risk in the sector, including the relevant NAO and PAC reports (referred to previously), analysis of those councils that have experienced financial failure and the government's monitoring and review of local authority data. Further detail is given on each metric in the following section.

21. Under the LUR Bill provisions, the power to take action is available if any one of the metrics are breached. Therefore, for each metric, there must be a value which can be calculated for any given local authority on a consistent basis, that determines whether that authority has breached the threshold for that metric. The purpose of this consultation is to seek views on appropriate calculations which give a reasonable reflection of an authority's level of risk for that metric, which then inform the local authority coming into scope of Secretary of State's powers under the LUR Bill.

Scope of the consultation

22. At the time that the new capital powers were announced, the government was clear on the importance of working with the sector to determine the way in which the metrics would be calculated. It is important for the government to understand the impacts, risks and benefits of the different options, recognising that there are multiple ways in which each metric can be calculated based on the data and formula used.

23. The consultation will be used to collect views and the evidence will be carefully considered in deriving the final metric calculations that will underpin powers in the LUR Bill. Alongside this consultation, the government will collect evidence from the sector through other forms of engagement and stakeholders will be made aware of this in due course.

24. The consultation is only asking for views on the *calculation* of the metrics. This consultation is not asking specifically for views on the precise value of the threshold for the metrics at this time – the primary purpose is to establish the calculations. However, this consultation and concurrent engagement will provide evidence to inform those thresholds.

Matters for consideration

25. This consultation seeks for you to consider the risk calculations which would sit under the risk metrics outlined in paragraph 19.

26. The calculations should meet all four of the following principles:

    - **Appropriate:** the calculations should be such that they identify those authorities that are at greater risk from their capital activities.
    - **Sufficient:** the calculations should be such that the majority of authorities with excessive risk are expected to be identified.
    - **Readily calculable:** the calculations should be based on data that is robust, accessible for analysis and produced on a consistent basis as part of existing finance data reporting.
    - **Understandable and transparent:** the calculations should be transparent and understandable with respect to how the metrics are calculated.

27. Therefore, calculations that are very complex, that are based on data which is not widely available or consistent across the sector, or that do not effectively correlate with excessive risk are not consistent with these principles. To meet the objectives of consistency and understandability, where possible the metrics will use data captured through the existing sector data returns, and use definitions consistent with the statutory codes, the Code of Practice on Local Authority Accounting or Service Reporting Code of Practice for Local Authorities ("SeRCOP").

28. The metrics are intended to be broadly consistent with existing metrics such as those the prudential indicators in the Prudential Code, but will not necessarily be exactly the same given the different purpose.

29. This consultation lists the different options for calculations under the four risk metrics. For each metric, a proposed calculation is presented with a number of alternative options offered for comment. The LUR Bill sets out four metrics – in practice, this means that there cannot be multiple sub-calculations per metric. This does not preclude combining multiple formulae as the basis for a single metric, but each metric must have *one output value* against which authorities will be assessed. Multiple calculations are presented in this document only to enable discussion on the alternatives.

30. When determining thresholds, it is intended that upper tier local authorities and lower tier authorities (as defined by the Office of National Statistics classifications for upper and lower tiers) are considered separately as they have very different structures and are likely to have very different capital financing needs as a result. Further, certain authorities are not in our calculations and thresholds, e.g. waste authorities and police and crime commissioners and chief constables, due to their structure and because they do not have the general power of competence conferred by the Localism Act 2011.

Risk metric one: the total of a local authority's debt (including credit arrangements) as compared to the financial resources at the disposal of the authority

31. The objective of this metric is to identify those authorities that carry a *disproportionate* level of debt. That is, where an authority holds a level of debt significantly in excess of its size (financial resources) so as to present an *excessive* level of risk to financial sustainability. This metric is consistent with government's statutory guidance and the Prudential Code.

32. Under statute, a local authority must determine and keep under review the level of borrowing it can afford and it may not borrow in excess of this. Debt is a liability that must ultimately be funded from capital or revenue resources over time. Interest costs and the duty to make minimum revenue provision ("MRP") result in an inflexible revenue cost that needs to be managed within the balanced budget requirement over the life of the borrowing. For the debt to be affordable, an authority must be able to meet these costs from its future revenue streams while also meeting the costs of delivering its services. In making an assessment of affordability, an authority must have regard to the Prudential Code.

33. Starting around 2016/17, a small number of authorities have accumulated debt many times their size. In most cases, the cost of the debt is met through profits made by investing the borrowing. Where an authority carries debt far in excess of its financial capacity, there is an inherent risk to financial sustainability should future revenues fall and the costs of servicing the debt can no longer be met. There is also a risk that asset values, financed by borrowing, fall below the purchase cost, leaving the council with liabilities in excess of their assets. It is accepted that all debt carries some risk, however, as set out in the government's Statutory Guidance on Local Government Investments, authorities need to consider the long-term sustainability risk implicit in taking out too much debt where there is no realistic prospect of their revenues being sufficient to pay back debt that is many multiples of their sustainable income.

34. Proportionality of debt is also addressed in the Prudential Code. The version issued in December 2021 contains enhanced guidance on the concept of proportionality to ensure that capital expenditure and investment plans are affordable and proportionate. It sets out that authorities should calculate their financing costs as a percentage of net revenue stream as a 'prudential indicator' (metrics authorities should use to monitor their position against the objectives of the Prudential Code). Although the Prudential Code does not set specific limits, it makes clear that authorities must consider the level of their debt relative to their financial capacity and assess the risk this poses to affordability.

35. In a number of cases, where councils have experienced financial failure, or otherwise required government support or intervention, disproportionate levels of debt have contributed to financial unsustainability, and demonstrated the difficulties faced where excessive debt has led to an unfunded liability many times the size of the authority's resources.

36. The purpose of this metric and its underlying calculation is to identify those authorities where the relative size of debt presents an excessive level of risk.

i. Risk Metric 1 - proposed calculation

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.

37. Capital finance requirement ("CFR") is an established concept with the definition provided in the Prudential Code. It is also a value that is collected through the annual capital returns. It is the measure of total indebtedness due to capital expenditure, as it represents the capital expenditure that is financed by debt (whether internal or external borrowing). It is used in the calculation rather than any other measure of debt, such as level of borrowing, on the premise it most accurately represents an authority's full level of debt. As set out in the Prudential Code, CFR is normally expected to be a higher value than external borrowing, as many authorities use internal borrowing to finance capital spend.

38. Total service expenditure ("TSE") is collected as part of the annual revenue returns, and is defined in the associated guidance. It is the net cost of delivery services by an authority and does not include investment income or costs. It is used in this metric on the premise that it provides a good measure of the 'size' of an authority.

39. The calculation uses the ratio between CFR and TSE as the measure of proportionality of an authority's level of debt relative to its size.

ii. Alternative calculations

1(b) Capital Finance Requirement / Core Spending Power	Similar to calculation 1(a), but uses Core Spending Power (CSP) as the measure of an authority's 'size' rather than TSE. Our testing of the calculations indicates that using either CSP or TSE produce very similar results, and these values will closely correlate for any given authority. However, we understand from initial testing of the calculations that TSE may be a more recognised and accepted measure.

1 (c) Total debt change / Total capital expenditure:	Change in CFR from one financial period to another is divided by total capital expenditure for that same period. Total capital expenditure is taken from the capital returns and is the total capital spend for all purposes for a particular financial year. This calculation works on the premise that the change in CFR represents the total amount by which an authority has increased its debt in a given year, and dividing this by total capital spend gives the proportion of capital expenditure financed by debt rather than from capital resources. The calculation is based on change in debt, so is less likely to highlight authorities with high levels of debt from historic activity, unless a multi-year approach is taken. The calculation is also likely to require a secondary step. An authority undertaking a relatively small amount of capital spend entirely financed by debt would be flagged by this calculation. This is not necessarily useful in identifying risk – therefore, some filter would be needed to only apply the calculation to authorities taking on relatively large levels of capital expenditure financed by debt.
1 (d) Fixed debt costs / Total service expenditure	Fixed debt costs are those costs that are incurred due to holding debt including credit arrangements. For this calculation, they are the sum of Minimum Revenue Provision + finance leasing costs + PFI costs + interest costs (as recorded in the annual revenue returns). This is divided by TSE as a measure of an authority's size. This calculation is similar to 1(a) and 1(b) in that it gives an indication of the current level of debt held by an authority, relative to its size, but uses the revenue impact of that debt rather than the measure of debt itself. One issue with this calculation is that it includes Minimum Revenue Provision and only functions accurately if all authorities are charging this consistently. Issues with Minimum Revenue Provision are outlined later in this document, but there is a risk that some authorities are undercharging MRP and therefore debt costs will appear lower.
1 (e) Fixed debt costs / Core spending power	Similar to 1(d) but CSP is used in place of TSE as the measure of an authority's size.

Questions

- **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation (calculation 1(a)) should be the basis for this metric? YES/NO**

  Please explain.

- **Are any of the alternative calculations more appropriate than the proposed calculation? YES/NO**

  Please explain.

- **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

Risk metric two: the 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

40. This metric is intended to identify where an authority is exposed to risk due to the extent to which is has incurred capital expenditure mainly or only for a financial return, as opposed to meeting service needs or priorities such as housing provision, regeneration or net zero. This does not preclude the fact that authorities may invest in housing, net zero, regen where the objective is still mainly one of profit.

41. Since November 2020, the lending terms of the Public Works Loan Board do not permit lending to authorities that have or intend to invest primarily for yield. The revised Prudential Code also makes clear that authorities should not invest primarily for yield. While these reforms appear to have stopped the trend of authorities borrowing to invest for profit they do not address existing risks from historical practices. It is also possible that authorities may invest for objectives such as regeneration, but the assets become assets held for profit overtime. Lastly, while most authorities adhere to the Prudential Code, it is important for the government to be able to identify and address potential instances where, by accident or intent, authorities continue to invest primarily for profit. It is not the government's intent to stop authorities owning assets that provide commercial profit, however, as with all the metrics, the intent is to identify where outlier practices create excessive risk to financial sustainability.

42. This metric may be linked to risk metric one, as stated, some authorities have been able to take on borrowing many times their financial resources because they then use the borrowed funds to invest for profit, which can be used to service the debt costs. However, authorities may also be exposed to risk where they are reliant on investment income to meet the costs of service delivery irrespective of the quantum of debt they hold. It is, therefore, possible than an authority holds excessive risk as determined by this risk metric, but not risk metric one.

43. As highlighted in the National Audit Office report, Local authority investment in commercial property, "*where authorities derive a significant amount of income from their commercial properties, the failure or under performance of these investments has the potential to affect levels of local service provision*". The focus of this report was on commercial property, but the risk can equally apply to any investment.

i. Risk Metric 2 - proposed calculation

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.

44. Investment income refers to non-treasury investment income. This is a line item in the general fund revenue account outturn since 2021/22 (line 821 as described in the guidance). This is income generated through investment properties and financial investments.

45. The calculation results in the metric showing the proportionality of investment income relative to the size of an authority. As with risk metric one, using absolute values does not recognise the different sizes of authorities, and so a measure is needed to normalise the data for comparative purposes. In this case, by dividing by the TSE, which has the same meaning and purpose here as in risk metric one.

46. The benefit of this calculation is that it should give a clear indication of the total stock of investments held for profit. As stated earlier in this document, and consistent with all the metrics, it is not the intent to say that generating investment for profit is problematic in itself, but this metric should serve to identify outliers. Where an authority has investment income many times its size, for example, it is more *probable* that it has borrowed to invest or is overly reliant on investment income to service debt costs or deliver services.

ii. Alternative calculations

2(b) Investment income / Core spending power	Identical to 2(a) except core spending power is used as the measure of the size of an authority. As for calculation 1(b), the question is whether CSP or TSE is more accepted as a measure of an authority's size.
2(c) Commercial expenditure / Total capital expenditure	This calculation looks at the proportion of total capital spend in a given period of time, which is for commercial purposes. Commercial expenditure is taken directly from the capital returns and is Total Industrial & Commercial Trading (for fixed assets and financial expenditure). As set out in the guidance, the commercial categories should be used where the overriding reason for expenditure it to provide future revenue. Capital expenditure is total capital expenditure for all categories. The premise of this calculation is to identify risk by looking at capital spend, rather than revenue. A limitation is that this calculation does not capture *stock* of investments because it only takes into account in-year expenditure. Unless a multi-year calculation is used, or the calculation is combined with 2(a) or 2(b).
2(d) Total capital expenditure / Total service expenditure	This calculation looks at the total capital expenditure in relation to the size of the authority (using TSE as a measure of size).

	Where a local authority is spending a disproportionate amount of capital spend compared to its size, the assertion is that it is probable that the authority is borrowing to do so and is investing for profit. A limitation is that this calculation does not capture *stock* of investments because it only takes into account in-year expenditure. Unless a multi-year calculation is used, or the calculation is combined with 2(a) or 2(b).

Questions

- **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation (calculation 2(a)) should be the basis for this metric? YES/NO**

  Please explain.

- **Are any of the alternative calculations more appropriate than the proposed calculation? YES/NO**

  Please explain.

- **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

Risk metric three: The 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

47. The purpose of this metric is to consider risk that may arise due to the source and nature of debt. Risk metrics one and two are concerned with the level of debt relative to size and dependency on commercial income respectively. However, risk can also arise due to the nature of debt.

48. Concerns over this were expressed in the PAC report ‘Local authority investment in commercial property’, with respect to novel arrangements such as income strips. Local authority borrowing is not limited to conventional loans, and the Prudential Framework specifically includes credit arrangements (including securitisation). Excessive risk can be present where authorities are borrowing a prudent amount, but imprudently incurring credit liabilities. It is also possible that excessive risk could be a result of the source and terms of borrowing. That is not to say that there is a specific systemic risk at this time, but the Framework needs to have the ability to address this should it arise.

49. This metric therefore considers the extent and cost of counterparty debt, including credit arrangements, in determining risk. This is not to say that all non-government debt is risky; for some non-government debt, institutions may put local authorities through greater scrutiny to assess risk than the PWLB would. Nevertheless, risk may arise from nature of the debt itself and it is therefore considered appropriate to have a method of calculation that reflect this. It is important that the Framework is able to respond to the various and complex arrangements for debt/borrowing should risks emerge in the system.

i. Risk metric 3 - proposed calculation

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.

50. Gross external debt figures are taken from the annual capital returns, while central and local borrowing is taken from the quarterly borrowing and investment returns. Gross external debt figures are used, rather than CFR, as it is external debt that this metric is concerned with.

51. Most local authority borrowing is from the PWLB (over 70% as at 31 December 2022). The metric is not to imply that all non-government debt is risky, but identifying those authorities where an unusually high proportion of debt is not from government should identify where it is *probable* that an authority is using less typical forms of debt-financing.

ii. Alternative calculations

3(b) Credit arrangements / Total borrowing	Credit arrangement values are ‘other long-term liabilities’ as recorded in the annual capital returns and defined in the Prudential Code, paragraph 97. This is divided by total external debt and gives the proportion of borrowing which is credit arrangements. The premise of this calculation is to identify those authorities where the debt is mostly non-traditional borrowing. This metric would not be effective at identifying risk from non-credit arrangement borrowing and would likely need to be combined with another calculation to meet the objectives of this metric.
3(c) Debt servicing costs/ Non-government borrowing	Interest costs taken from the annual revenue outturn forms and divided by non-government borrowing (same meaning as calculation 3(a)). This metric would identify authorities where interest costs on debt from non-government sources were atypically high – a potential indicator that the authority has not effectively managed its interest rate risks. This metric would not be effective at identifying other forms of risk and would likely need to be combined with another calculation to meet the objectives of this metric.
3(d) Short-term borrowing / Total borrowing	Short term borrowing is the total short-term borrowing taken from the annual capital returns or the quarterly borrowing and investment live tables. This is divided by total borrowing. To identify authorities with an atypical ratio of long-term to short-term debt. This metric would not be effective at identifying other forms of risk and would likely need to be combined with another calculation to meet the objectives of this metric.

Questions

- **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation (calculation 3(a)) should be the basis for this metric? YES/NO**

  Please explain.

- **Are any of the alternative calculations more appropriate than the proposed calculation? YES/NO**

  Please explain.

- **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

Risk metric four: The amount of minimum revenue provision charged by a local authority to a revenue account for a financial year.

52. The duty to make MRP is set out in the *Local Authority Capital Finance and Accounting Regulations 2003* ("the Regulations"), which specifies the need to make a 'prudent' charge to revenue each year with respect to an authority's outstanding debt. This means a cost is charged to the revenue budget and money is put aside for future debt repayment.

53. Legislation does not prescribe what constitutes a 'prudent' amount, however, guidance and best practice is set out in the government's Guidance on Minimum Revenue Provision. Authorities are required to 'have regard' to this guidance, which means, as set out in the guidance itself "*authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified*". While authorities have some flexibility in setting the MRP charge, it must still be 'prudent'.

54. Under-charging of MRP creates risk to the authority, the finance system, and to local and national taxpayers. Under-provision can result in an authority being unable to repay a proportion of its debt, passing the liability into the future, which will then need to be met from capital receipts or accelerated MRP payments. Further, if a prudent charge is not made, then this can also allow the authority to take on greater levels of debt than would otherwise be affordable. The duty to make MRP is an important mechanism in the Framework to constrain risk and ensure affordability of capital decisions.

55. The statutory guidance on MRP was updated in 2018, effective from April 2019. Since then, evidence came to light that some local authorities were employing practices which, in the government's view, are not consistent with the objectives of the statute and guidance, and that result in the underpayment of MRP. This was highlighted as a risk by the NAO report on local authority commercial investment, and the subsequent PAC report recommended that the government review compliance with the MRP duty and determine if further action was needed. To address the identified issues, and in accordance with the PAC recommendation, the government consulted on proposed changes to the Regulations in late 2021 and then again in summer 2022. A further consultation on updated guidance in planned for spring 2023, before regulation changes are made. The government has said the earliest any changes will take effect is from April 2024.

56. Evidence for the importance of adherence to the MRP duty has been illustrated by recent examples of authorities experiencing financial difficulty and requiring government support. In a number of cases, subsequent review found that historically adequate MRP had not been made. This will have contributed to current financial difficulties by both allowing those authorities to take on levels of debt they could not otherwise afford, and means they do not have sufficient revenue resources set aside from prior years to address issues with debt.

57. In light of the known issues with MRP practices, the evidence of the link to authorities that have experienced financial problems, this metric is intended to identify those authorities that may be making insufficient MRP. That is, where the amount of MRP made is not, in the government's view, prudent.

i. Risk metric three - proposed calculation

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.

58. Authorities report the annual MRP cost in both the annual revenue return and the capital return. These values should match. This calculation expresses the annual MRP charge as a proportion of the CFR. The CFR attributable to the housing revenue account is subtracted because authorities are not required to make MRP on CFR debt.

59. Where an authority's MRP as a proportion of CFR is exceptionally low, this is taken to be an indicator that that the authority may be underproviding for MRP. The government does recognise that there may be legitimate reasons why MPR is relative to CFR, for example, MRP does not need to be charged where assets are still be constructed. However, the calculation would serve to highlight those instances where is it more probable that MRP is not being charged a prudent level.

Questions

- **Considering the objectives set out in this document, and the principles set out, do you agree that the proposed calculation (calculation 3(a)) should be the basis for this metric? YES/NO**

  Please explain.

- **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.

About this consultation

This consultation document and consultation process have been planned to adhere to the Consultation Principles issued by the Cabinet Office.

Representative groups are asked to give a summary of the people and organisations they represent, and where relevant who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Environmental Information Regulations 2004 and UK data protection legislation. In certain circumstances this may therefore include personal data when required by law.

If you want the information that you provide to be treated as confidential, please be aware that, as a public authority, the Department is bound by the information access regimes and may therefore be obliged to disclose all or some of the information you provide. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department for Levelling Up, Housing and Communities will at all times process your personal data in accordance with UK data protection legislation and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. A full privacy notice is included below.

Individual responses will not be acknowledged unless specifically requested.

Your opinions are valuable to us. Thank you for taking the time to read this document and respond.

Are you satisfied that this consultation has followed the Consultation Principles? If not or you have any other observations about how we can improve the process please contact us via the complaints procedure.

Personal data

The following is to explain your rights and give you the information you are entitled to under UK data protection legislation.

Note that this section only refers to personal data (your name, contact details and any other information that relates to you or another identified or identifiable individual personally) not the content otherwise of your response to the consultation.

1. The identity of the data controller and contact details of our Data Protection Officer

The Department for Levelling Up, Housing and Communities (DLUHC) is the data controller. The Data Protection Officer can be contacted at dataprotection@levellingup.gov.uk or by writing to the following address: Data Protection Officer, Department for Levelling Up, Housing and Communities, Fry Building, 2 Marsham Street, London SW1P 4DF.

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

We will collect your IP address if you complete a consultation online. We may use this to ensure that each person only completes a survey once. We will not use this data for any other purpose.

Sensitive types of personal data

Please do not share special category personal data or criminal offence data if we have not asked for this unless absolutely necessary for the purposes of your consultation response. By ‘special category personal data’, we mean information about a living individual’s:

- race
- ethnic origin
- political opinions
- religious or philosophical beliefs
- trade union membership
- genetics
- biometrics
- health (including disability-related information)
- sex life; or
- sexual orientation.

By ‘criminal offence data’, we mean information relating to a living individual’s criminal convictions or offences or related security measures.

3. Our legal basis for processing your personal data

The collection of your personal data is lawful under article 6(1)(e) of the UK General Data Protection Regulation as it is necessary for the performance by DLUHC of a task in the public interest/in the exercise of official authority vested in the data controller. Section 8(d) of the Data Protection Act 2018 states that this will include processing of personal data that is necessary for the exercise of a function of the Crown, a Minister of the Crown or a government department i.e. in this case a consultation.

Where necessary for the purposes of this consultation, our lawful basis for the processing of any special category personal data or 'criminal offence' data (terms explained under 'Sensitive Types of Data') which you submit in response to this consultation is as follows. The relevant lawful basis for the processing of special category personal data is Article 9(2)(g) UK GDPR ('substantial public interest'), and Schedule 1 paragraph 6 of the Data Protection Act 2018 ('statutory etc and government purposes'). The relevant lawful basis in relation to personal data relating to criminal convictions and offences data is likewise provided by Schedule 1 paragraph 6 of the Data Protection Act 2018.

4. With whom we will be sharing your personal data

DLUHC may appoint a 'data processor', acting on behalf of the Department and under our instruction, to help analyse the responses to this consultation. Where we do we will ensure that the processing of your personal data remains in strict accordance with the requirements of the data protection legislation.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for two years from the closure of the consultation, unless we identify that its continued retention is unnecessary before that point.

6. Your rights, e.g. access, rectification, restriction, objection

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right:

a. to see what data we have about you
b. to ask us to stop using your data, but keep it on record
c. to ask to have your data corrected if it is incorrect or incomplete
d. to object to our use of your personal data in certain circumstances
e. to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

Please contact us at the following address if you wish to exercise the rights listed above, except the right to lodge a complaint with the ICO: dataprotection@levellingup.gov.uk or Knowledge and Information Access Team, Department for Levelling Up, Housing and Communities, Fry Building, 2 Marsham Street, London SW1P 4DF.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.