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| Item No: 2.2 | Classification: Open | Date: 28 February 2020 | Meeting Name: Council Assembly |
| Report title: | | Capital Strategy and Treasury Management Strategy 2020-21 | |
| Wards or Groups affected: | | All | |
| From: | | Strategic Director of Finance and Governance | |

RECOMMENDATIONS

That council assembly notes:

1. That the council continues to invest in an ambitious long term capital programme that provides significant ongoing benefits throughout the borough and revenue streams to support council services.
2. The HM Treasury decision on 9 October 2019 to increase the interest rate margin added to new borrowing from the Public Works Loan Board from 0.8% to 1.8%.

That council assembly approves:

3. The Capital Strategy 2020-21 as Appendix A.
4. The Treasury Management Strategy Statement 2020-21 as Appendix B
5. The Investment Management Strategy 2020-21 as Appendix C
6. The Minimum Revenue Provision Statement 2020-21 as Appendix D
7. The Prudential Indicators for 2020-23 as Appendix E

BACKGROUND INFORMATION

8. Southwark council has long tradition for investment in local infrastructure and facilities that support the development of the borough for the benefit of residents and businesses. This investment has been sustained throughout the recent period of austerity and has fundamentally supported the generation of new financial resources from council tax, retained business rate growth and new homes bonus. These revenue streams have helped to support basic council services and continued capital investment will seek to enhance this income further.
9. Each year council assembly agrees an annual strategy covering the management of council debt, capital and treasury investments. The strategy is to be agreed following consultation with the audit, governance and standards committee.
10. Treasury management is the management of the authority's cash flows, borrowing and investments. The council is exposed to financial risks from treasury management activity including possible losses associated with

council investment and potential for increased borrowing costs arising from market movements. The identification, monitoring and control of financial risks are therefore a crucial part of the financial management and governance arrangements of the council.

11. Commencing in 2019-20 the council is required to produce a capital strategy report (Appendix A) providing a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how any associated risks are managed and the implications for future financial sustainability.
12. Under financial delegation, the strategic director of finance and governance is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that these responsibilities can be carried out effectively.

KEY ISSUES FOR CONSIDERATION

Borrowing strategy and debt management activity and position

13. The council's debt management strategy is to pursue a policy of internal borrowing, which is the use of existing reserves and balances to temporarily fund capital expenditure, where possible, rather than the use of external borrowing.
14. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances.
15. In 2017-18 to finance capital expenditure and to maintain minimum cash balances the council borrowed for the first time since 2012. The extent of the council's capital expenditure plans has necessitated further borrowing during 2018-19 and 2019-20.
16. In the financial year to 31 March 2019 the council borrowed £117m from the Public Works Loans Board (PWLB), as part of HM Treasury, in 13 separate loans, with maturity terms ranging from 35 to 49 years at an average interest rate of 2.49%.
17. In the current financial year to 31 December 2019 the council has borrowed a further £32.5m from the PWLB in three tranches ranging from eight to 40 years at an average rate of 1.75%.
18. Drawing of long term borrowing has been supplemented by a continuation of short term borrowing from other local authorities to reduce the overall debt interest expense for the council. The level of short term borrowing from other local authorities as at 31 March 2019 was £120m. The weighted average rate of interest for current short term debt held by the council as at 31 December 2019 is 0.87%.
19. The council has an ambitious capital programme for both General Fund and Housing Revenue Account capital expenditure, including substantial delivery

of new homes and regeneration schemes, as set out in the approved Capital Programme Refresh 2018-2028.

20. Projections for this capital expenditure and financing, as well as long term cashflow forecasts indicate that the council may require £1bn of additional borrowing by the end of 2025.

Public Works Loan Board

21. In October 2019, a percentage point increase in the rate of borrowing from the PWLB was announced, with immediate effect, leading to an increase in the future interest cost for the council from new borrowing.
22. All historical long term debt for the council has been drawn from the PWLB. However future borrowing could come from a variety of different sources. Following the rate increase, the council will continue to review alternative sources of borrowing to the PWLB. Any borrowing decision will be made in consideration of capital and cashflow forecasts, market conditions, interest rate expectations and with respect to associated risks. The council will also utilise the advice of its external treasury advisor Arlingclose.

Proposed Investment Strategy

23. The council's investment objectives for treasury management are to preserve principal, provide liquidity and secure a return on investments consistent with the prior objectives of security and liquidity. This is in line with investment guidance produced by the Ministry of Housing, Communities and Local Government
24. The annual investment management strategy 2020-21 is attached at Appendix C. The strategy will allow investment across highly rated sovereigns, banks and other corporates, quasi-sovereigns, covered bonds whilst limiting excessive exposure to market volatility, and maintaining the overarching objective of ensuring appropriate security and liquidity. External fund managers will be utilised to implement the strategy when appropriate.
25. In considering the investment strategy for 2020-21 the council has taken advice from the external treasury advisor Arlingclose, in addition to ongoing engagement with the council's external fund managers, to ensure that any investment limits and restrictions remain appropriate to meet the investment objectives.
26. The investment strategy for the council for 2020-21 is proposed to remain unchanged as it is considered overall to be well structured to limit any undue risks to the security of assets and preservation of liquidity whilst also allowing the council and delegated managers to access suitable investment opportunities.

Minimum Revenue Provision

27. Each year, the General Fund sets aside sums known as the minimum revenue provision (MRP) to reduce its borrowing liabilities. The HRA may also set aside sums to reduce its own borrowing liabilities. The policy for MRP is set out in Appendix D and complies with the new guidance issued by MHCLG in 2018.

28. Government guidance on the MRP requires that the general fund set aside prudent sums to reduce debt and long term liabilities (such as PFI schemes) arising from capital spend and that the council produces a statement on its MRP policy. MRP costs fall on revenue budgets and runs on for many years into the future, usually over the period to which the capital item provides an economic benefit or the duration of the revenue grant supporting the expenditure.
29. Under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, a local authority is required to charge a minimum revenue provision annually to its revenue account in respect of capital financing obligations that arise in that year or arose in any prior year. Capital financing obligations represent debt or long term liabilities taken to fund capital expenditure.
30. A council may not change the total MRP it is liable for but may prudently modify the timing of payments to improve affordability and take account of individual spend and financing characteristics.

Prudential Indicators

31. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance and the Treasury Management in the Public Services Code of Practice and Guidance published by the Chartered Institute of Public Finance and Accountancy, backed by the Local Government Act 2003. The codes introduced a series of indicators and limits, which the council assembly should agree annually.
32. The indicators for approval relate to 2020-21 to 2022-23 and are set out at Appendix E. The indicators are of a technical nature and include a self imposed authorised limit on debt which the council assembly must determine each year. Approval will ensure that the council meets its obligations under the 2003 Act and that the strategic director of finance and governance can carry out their financial responsibilities in this area.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

33. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit and governance committee.
34. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a quarterly basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and governance.
35. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and

investment strategies, determining or changing borrowing limits or prudential indicators.

36. Section 15(1) of the 2003 Act requires a local authority “to have regard (a) to such guidance as the Secretary of State may issue”. This guidance is found in the Ministry of Communities and Local Government Guidance on Local Authority Investments updated February 2018 and there is statutory guidance on the Minimum Revenue Provision (MRP) produced under amendments made to section 21(1A) of the 2003 Act by section 238(2) of the Local Government and the Public Involvement in Health Act 2007.
37. Members are advised to give approval to the recommendations, ensuring continuing compliance with Government guidance and CIPFA’s codes.

BACKGROUND DOCUMENTS

| Background Papers | Held at | Contact |
|-------------------|---------|---------|
| None | | |

APPENDICES

| No. | Title |
|------------|--|
| Appendix A | Capital Strategy 2020-21 to 2028-29 |
| Appendix B | Treasury Management Strategy 2020-21 |
| Appendix C | Annual Investment Management Strategy 2020-21 |
| Appendix D | Annual Minimum Revenue Provision Statement 2020-21 |
| Appendix E | Prudential Indicators - 2020-23 |

AUDIT TRAIL

| | | |
|---|--|--------------------------|
| Lead Officer | Duncan Whitfield, Strategic Director of Finance and Governance | |
| Report Author | Rob Woollatt, Departmental Finance Manager | |
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| CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER | | |
| Officer Title | Comments sought | Comments included |
| Director of Law and Democracy | Yes | Yes |
| Strategic director of finance and governance | N/A | N/A |
| Cabinet Member | Yes | Yes |
| Date sent to constitutional team | 14 February 2020 | |