Open Agenda

Council Assembly

Wednesday 11 July 2018
7.00 pm
Council Offices, 160 Tooley Street, London SE1 2QH

Supplemental Agenda No. 1

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Date: 6 July 2018

Item No: 6.3	Classification: Open	Date: 11 July 2018	Meeting Name: Council Assembly
Report title:		Treasury Management Performance – 2017-18 Annual Report and Prudential Indicators for Capital Finance and Treasury Management and Draft Capital Strategy	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATION

1. That council assembly notes the 2017-18 outturn for the council's treasury management and that:

   - all treasury management activity was undertaken in compliance with the approved treasury management strategy and with the council's prudential indicators, as Appendix A.
   - the balance remaining on all external loans at 31 March 2018 was £563m (£371m HRA and £192m general fund). Loans totaling £5m were repaid during the year. £110m of new temporary borrowing was undertaken during the period.
   - in the year to 31 March 2018 the average investment balance was £127m and the balance of investments at 31 March 2018 stood at £126m.

2. That council assembly notes the council's draft Capital Strategy, as Appendix B.

BACKGROUND INFORMATION

3. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Code requires local authorities to determine an annual treasury management strategy and, as a minimum, formally report on their treasury activities and arrangements to council assembly mid-year and after the year-end.

4. The Code provides the following objective with regard to treasury management:

   "It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

5. The 2017-18 treasury management strategy was approved by council assembly in February 2017. Under financial delegation, all executive, managerial and operational decisions are the responsibility of the strategic director of finance and governance.

6. The council is exposed to financial risks from short term investments, existing external debt, as well as future borrowing requirements arising from the

council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates.

7. The key issues covered in this report are:

- Local authority regulatory changes
- The council's borrowing strategy and debt management position
- Investment performance and activity
- Prudential indicators for 2017-18.

KEY ISSUES FOR CONSIDERATION

Local Authority Regulatory Changes

Revised CIPFA Codes

8. In December 2017, following a consultation exercise in September 2017, CIPFA published revised editions of the Treasury Management and Prudential Code. The additional requirements of the revised Treasury Management and Prudential Code, as outlined below, are being incorporated into treasury management strategies and monitoring reports.

9. In the 2017 Treasury Management Code the definition of 'investments' has been widened to include additional financial assets as well as non-financial assets held primarily for financial returns, such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be presented in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

10. The objective of the Prudential Code is to provide a framework such that individual local authority capital investment plans are affordable, prudent and sustainable.

11. The 2017 Prudential Code introduces the requirement for an authority to produce a Capital Strategy to provide a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability.

12. The Prudential Code does not prescribe specific indicators or metrics that the Capital Strategy must utilise in order to assess the affordability and sustainability of capital and debt plans. The Code recommends that the Capital Strategy should include sufficient information about the council's long term capital expenditure expectations, council assets and liabilities in such detail to allow elected members to understand how value for money, prudence, sustainability and affordability will be secured.

13. Where this strategy is produced and approved by council assembly, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

14. The requirement to produce a Capital Strategy as per the 2017 Prudential Code is effective from April 2019. However the council has taken the decision to produce a draft Capital Strategy in advance of the deadline, in order to ensure early consideration of the strategy and the context in which capital and investment decisions are made. The draft Capital Strategy for 2019-20 is attached as Appendix B.

15. The 2019-20 Treasury Management Strategy, including the Capital Strategy, will be presented to council assembly for approval in February 2019.

MHCLG Investment Guidance and Minimum Revenue Provision

16. In February 2018 the Ministry of Housing, Communities and Local Government (MHCLG) published revised guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP). Local authorities are required to have regard to the revised guidance in consideration of capital, debt and investment decisions.

17. Changes to the investment guidance include a wider definition of investments to include non-financial assets held primarily for generating income return, typically investment property. This also extends coverage to a new category called “loans” (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate).

18. The investment guidance specifies additional reporting and disclosure requirements as part of the Capital and Treasury Management Strategy. The Investment Guidance is effective from 1 April 2018 with the additional disclosure requirements necessary as part of the capital and investment strategy for 2019-20.

19. The guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

20. During the financial year 2017-18 the council acquired a number of strategic property assets including four properties in London Bridge and property within Old Kent Road opportunity area. These were funded from prudential borrowing and part financed from rental income and potential future capital appreciation. It is expected that these assets will provide a long term, sustainable source of income for the council.

21. As at 31 March 2018 the value of investment properties owned by the council is £232m, £148m as at 31 March 2017. During the financial year 2017-18, investment property generated a gross income to the council of £13.6m, less direct property expenses of £4.4m.

22. The new statutory guidance on the MRP issued by MHCLG in February 2018 will be applicable for accounting periods from 1 April 2019 for which Southwark must have regard to when setting and applying MRP policy.

23. The guidance has sought to clarify what the government considered as prudent provision for the repayment of debt. This has included updated specification of individual asset lifetime over which provision is to be made for repayment, including an upper limit of 50 years in all but exceptional cases.

24. The definition of prudent MRP has been changed to “put aside revenue over time to cover the Capital Financing Requirement (CFR)” and any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

25. The council’s existing MRP policy is compliant with the new guidance.

MiFID II

26. As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3 January 2018 local authorities were automatically treated as retail clients but could “opt up” to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year’s relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

27. The authority has met the conditions to opt up to professional status and has done so in order to maintain its former MiFID II status prior to January 2018. The Authority will continue to have access to products including pooled bond funds, treasury bills, bonds and shares.

Prudential indicators - actuals

28. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related guidance published by CIPFA. The codes require councils to set a series of indicators and limits each year. The 2017-18 indicators were agreed in February 2017, before the start of the financial year and enabled the strategic director of finance and governance to carry out his responsibilities in this area. The 2017-18 Prudential Indicator outturn details are included at Appendix A.

29. The council has complied with its prudential indicators throughout 2017-18.

Borrowing strategy and debt management activity and position

30. The council’s debt management strategy since 2011-12 has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to fund capital expenditure rather than the use of external borrowing.

31. 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. Borrowing in advance of need creates a ‘cost of carry’ which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs.

32. During the period from 2011-12 to 2017-18 the rate of return on short term investments was consistently much lower compared to longer term borrowing. The savings for the council from deferring external borrowing in this way equate

to circa £20m.

33. 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.

34. During 2017-18, it became necessary to undertake new borrowing in order to finance prior internal borrowing from the capital programme and to maintain target cash balances. During the course of the financial year 2017-18 the council elected to borrow £110m in short term loans from other local authorities.

35. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal borrowing strategy, so that the reduction in current borrowing costs from use of internal balances, is not offset by higher borrowing costs in the future.

36. Future borrowing requirements arising from the approved capital programme, the extent of internal borrowing and the need to refinance scheduled debt repayments, together with forecast interest rate rises, indicate the need for long-term borrowing during 2018-19.

37. 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. The council could borrow through other financial institutions and banks, the Municipal Bond Agency, or directly from other local authorities. All short term borrowing during 2017-18 was via other local authorities. Borrowing from other local authorities is typically at lower rates than from other sources for short duration debt.

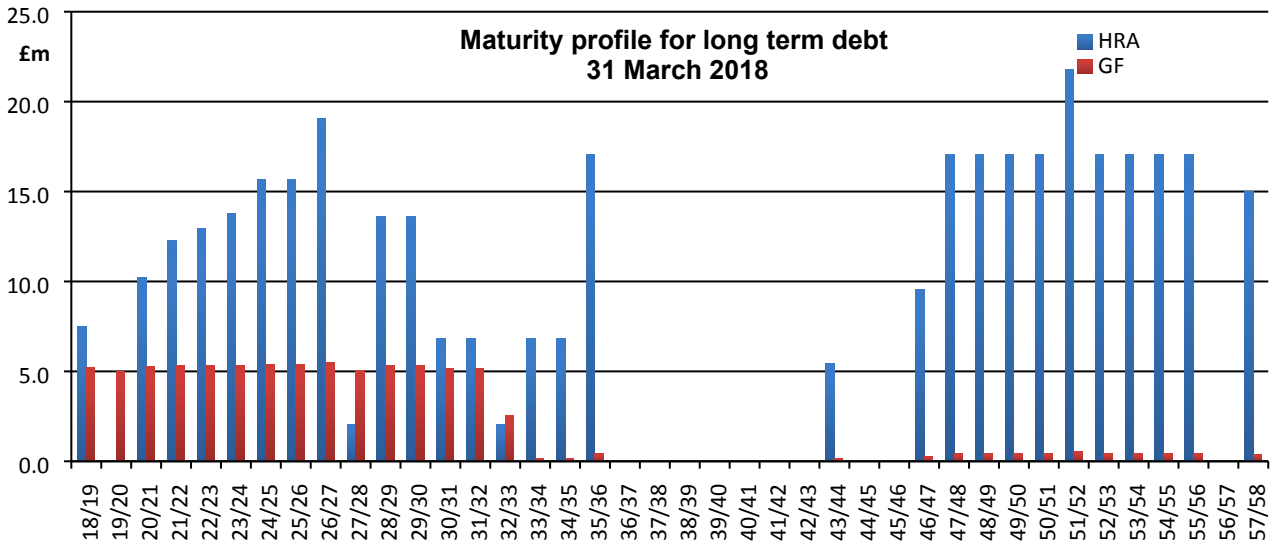
38. The council's outstanding debt portfolio, used to fund historical capital expenditure for the HRA and general fund, stood at £563m as at 31 March 2018 with £371m attributable to the HRA and £192m to the general fund.

39. All long term outstanding debt was borrowed from the Public Works Loans Board (PWLB), part of HM Treasury, at fixed rates of interest. During 2017-18, £5m of debt principal matured and was repaid to PWLB. All long term debt was drawn prior to 2011-12.

40. The total of short term borrowing drawn during 2017-18 was £110m at an average interest rate of 0.9%.

41. The weighted average rate of interest for the council's debt portfolio is 4.6% as at 31 March 2018. This reflects the largely historical nature of the debt, the majority of which was drawn prior to 2008.

42. The maturity profile of outstanding borrowings as at 31 March 2018 is shown in the chart below:



Provisions for repayment of debt

43. Each year, the general fund sets aside sums, known as the minimum revenue provision (MRP), to reduce its borrowing liabilities. In 2017-18 £6m (£7m during 2016-17) was set aside to reduce the capital financing requirement.

44. The HRA can also set aside sums to reduce borrowing liabilities. During 2017-18 no additional balances were set aside for repayment of debt. Due to capital expenditure required to be financed by borrowing of £37m incurred by the HRA during 2017-18, the headroom for future capital finance has decreased to £147m (£184m 2016-17).

45. The overall level of internal borrowing at 31 March 2018, after accounting for additional provisions, decreased by £64m to £164m (£127m general fund, £37m HRA). The decrease in internal borrowing reflects the £110m in short term borrowing drawn partially offset by capital spend that is not funded by existing resources, such as capital receipts or grants, after adjusting for debt repayment provisions. The council's capital spending programme is set out in more detail in the capital monitoring outturn report due to Cabinet in July 2018.

46. The PWLB continues to operate a spread of approximately 1% between "premature repayment rates" and "new loan" rates so the premium charge for early repayment of PWLB debt remained expensive for the council's portfolio and therefore unattractive for debt rescheduling activity.

47. The short term debt drawn during 2017-18 will mature in 2018-19 and there will be a requirement to refinance this by drawing down further borrowing. The council will consider a number of borrowing sources, both long and short term. Decisions on the most optimal and value for money source and duration of the borrowing will be made in the context of any changes in interest rates and the longer term cash flow requirements of the council. It is expected that further borrowing will also be required in 2019-20.

Investment strategy and investment activity and position

48. The council has significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Council cash that is not immediately required for current expenditure is invested in money market

instruments in accordance with the DCLG Guidance on Local Authority Investments and the approved investment strategy. The guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

49. In the year to 31 March 2018 the average daily investment balance was £127m (£188m for 2016-17) and the value at 31 March 2018 stood at £126m (£155m 2016-2017).

50. Council investments are managed both in-house and delegated to two external fund managers: Alliance Bernstein and Aberdeen Asset Management. The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and, to a lesser extent, call accounts and term deposits diversified across major banks and building societies.

51. The external fund managers invest over a longer term in UK government gilts, supranational bank bonds, and certificates of deposits and covered bonds issued by major banks/ building societies. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

52. The overall rate of return on investments during 2017-18 was 0.34%. In November 2017 the Bank of England's Monetary Policy Committee increased the bank base rate by 0.25% to 0.50%, with markets pricing further increases during 2018. The negative impact on asset price valuations from an increase in market yields dampened investment performance for the year.

53. The distribution of investments. by maturity and credit rating as at 31 March 2018 is set out in the table below:

Maturity Profile and Credit Rating				
	A	**AA**	**AAA**	**Grand Total**
Less than 1 year	3%	17%	56%	76%
1-2	0%	7%	7%	14%
2-5	2%	2%	6%	10%
Grand Total	**5%**	**26%**	**69%**	**100%**

AAA represents the highest credit quality, AA represents very high credit quality and A represents high credit quality.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

54. 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, governance and standards committee.

55. 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 regular 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.

56. The Local Government Act 2003 ("the 2003 Act") 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.

57. 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 Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) made under section 21(1A) of the 2003 Act.

58. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

Reason for urgency

59. In accordance with the CIPFA Code of Practice for Treasury Management and the Local Government Act 2003 council assembly is required to agree the annual treasury outturn report, covering treasury management activities over the prior year and compliance with the treasury management strategy, prior to 30 September of the following year.

Reason for lateness

60. Following recent changes to MHCLG statutory guidance on local authority investment and CIPFA Code of Practice for Treasury Management and the Prudential Code for Capital Finance, a decision was taken to bring a draft capital strategy to council assembly as part of the outturn report in order to ensure consideration of the capital strategy in advance of the final capital strategy which will be presented to council assembly for approval in February 2019.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
Appendix A	Prudential Indicators – 2017-18 Actuals
Appendix B	Draft Capital Strategy

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Rob Woollatt, Interim Departmental Finance Manager	
Version	Final	
Version Date	5 July 2018	
Key Decision	No	
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	Not applicable	Not applicable
Cabinet Member	Yes	Yes
Final Report sent to Constitutional Team		5 July 2018

APPENDIX A

PRUDENTIAL INDICATORS: 2017-18 ACTUALS

BACKGROUND

1. Capital finance, borrowing and investment arrangements are supported by a series of prudential indicators, drawn from the Prudential Code on Capital Finance for Local Authorities and the Treasury Management in the Public Services Code of Practice plus Guidance, published by CIPFA. The Local Government Act 2003 requires that councils have regard to these codes and this appendix sets out the 2017-18 outturn indicators drawn from the council's draft accounts for that year.

2. The indicators are grouped into three broad areas: affordability and prudence, capital finance and treasury management. The indicators are of a technical nature and existing budgets take account of capital finance and treasury activities. The indicators themselves have no effect on those budgets.

INDICATORS ON AFFORDABILITY AND PRUDENCE

3. The indicators below are for affordability and prudence.

2016-17	2017-18	
		Ratio of Financing Cost to Net Revenue Stream A measure of the cost of borrowing and long term liabilities (e.g. PFI) net of interest income and set-asides, as a percentage of revenue.
9%	9%	HRA
8%	8%	General fund
		Incremental Impact of Capital Spend A measure of the effect of capital plans in 2017-18 on council tax and rents.
N/A	£8	Weekly rents
£8	£7	Annual Council tax – band D
		Capital Financing Requirements (CFR) and Gross Debt The CFR is the balance remaining on past capital expenditure financed through debt and long term liabilities (e.g. PFI). The level of gross debt should not exceed the CFR unless prudent over the short term. Actual gross debt remained below the CFR throughout 2017-18 on account of cash balances, internal borrowing and PFI transactions.
£798m	£956m	CFR
£463m	£563m	Maximum Gross Debt in the Year

INDICATORS ON CAPITAL FINANCE

4. The indicators below are for capital finance.

2016-17	2017-18	
		Capital Expenditure Capital expenditure includes PFI funded spend.
£153m	£168m	HRA
£99m	£233m	General fund
£252m	**£401m**	**Total**
		Capital Financing Requirement (CFR) The CFR is the balance on past capital expenditure financed through borrowing and long term liabilities (e.g. PFI).
£393m	£430m	HRA
£405m	£526m	General fund
£798m	**£956m**	**Total**
		HRA Indebtedness Limit A limit determined by the government below which the HRA CFR must remain. The HRA CFR has remained within the indebtedness limit.
£577m	£577m	HRA indebtedness limit determined by the government
£393m	£430m	Actual HRA CFR
£184m	**£147m**	**HRA Headroom**

INDICATORS ON TREASURY MANAGEMENT

5. The indicators below are for treasury management.

2016-17 Outturn	2017-18 Limit	2017-18 Outturn	
			Operational Boundary on Debt and Authorised Limits for External Debt These are limits the council determines to accommodate borrowing and long term liabilities. The lower limit is the operational boundary and takes account of existing positions and ordinary activity and the higher limit is the authorised limit, enabling additional borrowing to be taken for very short periods, in the interest of prudence, within a risk controlled framework.
			Operational Boundary
£463m	£783m	£563m	Borrowing (maximum outstanding in year)
£105m	£110m	£101m	Other Long Term Liabilities
£568m	**£893m**	**£664m**	**Total**
			Authorised Limit
£463m	£1,088m	£563m	Borrowing (maximum outstanding in year)
£105m	£126m	£101m	Other Long Term Liabilities
£568m	**£1,214m**	**£664m**	**Total**

2016-17	2017-18 Limit	2017-18 Outturn	
69%	100%	78%	**Gross and Net Debt** An upper limit on net debt as a percentage of gross debt. The net debt has remained below gross on account of investments held to meet spend.
			Fixed and Variable Rate Upper Limits Limits recognising existing positions with flexibility to vary exposure within a risk controlled framework should it be prudent.
£463m	£1,088m	£563m	Fixed rate debt (maximum outstanding in year)
£0m	£272m	£0m	Variable rate debt
			Maturity Structure of Borrowing Limits accommodating existing positions with flexibility to vary exposure within a risk controlled framework.
1%	25%	22%	Under 1 year
3%	25%	1%	1 year and within 2 years
8%	50%	9%	2 years and within 5 years
23%	75%	17%	5 years and within 10 years
23	100%	52%	10 years and over
			Limits on Investments Greater than One Year Caps on the maximum exposure to longer investments, while recognising benefits from prudent exposure within a risk controlled framework.
20%	50%	23%	Percentage longer than one year
7 months	2 years	7 months	Overall maximum average maturity

APPENDIX B

DRAFT CAPITAL STRATEGY
2019-20 – 2028-29

1. INTRODUCTION AND BACKGROUND

This Capital Strategy is an overarching document which sets the policy framework for the development, management and monitoring of capital investment. The strategy focuses on core principles that underpin the council's capital programme; its short, medium and long-term objectives; the key issues and risks that will impact on the delivery of the programme; and the governance framework required to ensure the capital programme is delivered and provides value for money for residents of Southwark.

The capital strategy aligns with the priorities set out in the Council Plan and other key council strategies. The strategy is integrated with the medium term financial strategy and treasury management strategy.

Council Assembly will agree the capital strategy and programme at least once every four years and as necessary in the event of a significant change in circumstances.

2. CORE PRINCIPLES THAT UNDERPIN THE CAPITAL PROGRAMME

The key principles for the capital programme are summarised below and shown in more detail as Annex A.

- Capital investment decisions reflect the aspirations and priorities included within the Council Plan and supporting strategies
- Schemes to be added to the capital programme will be subject to a gateway process, prioritised according to availability of resources and scheme specific funding, fairer future for all commitments and factors such as legal obligations, health and safety considerations and the longer-term impact on the council's financial position.
- The cost of financing capital schemes, net of revenue benefits, are profiled over the lifetime of each scheme and incorporated into the annual policy and resources strategy and budget.
- Commissioning and procuring for capital schemes will comply with the requirements set out in the council's constitution, financial regulations and contract standing orders.

3. GOVERNANCE FRAMEWORK

The council's constitution requires the Council Assembly to agree the capital strategy and programme at least once every four years and in the event of a significant change in circumstances. The reports from the chief finance officer will consider the compliance of proposed schemes in the programme with the medium term financial strategy, the capital resources available to the council, the revenue implications of the proposed capital expenditure, and any other relevant information.

Democratic decision-making and scrutiny processes provide overall political direction and ensure accountability for investment in the capital programme. These processes include:

- Council Assembly approves the Council Plan which sets out the strategic priorities for the council
- Council Assembly is ultimately responsible for approving the Capital Strategy, Treasury Management Strategy and capital programme
- The Cabinet receives regular capital monitoring reports, approves variations to the programme and considers new bids for inclusion in the capital programme
- Portfolio holders are assigned projects in line with their responsibilities
- Scrutiny committees can call in Cabinet reports, receive and scrutinise reports
- All projects progressing to the capital programme follow the constitution, and financial regulations
- The capital programme is subject to internal and external audit.

Any new capital expenditure is set out as part of a thorough evaluation. The evaluation will outline the key benefits that are expected to arise from this programme in relation to council priorities. The evaluation will include the financial considerations such as the expected cost and funding sources identified. Any risks to either the delivery or cost forecasts are to be considered as part of an evaluation. Approval to spend on individual capital schemes will only be given once procedural guidelines have been complied with and assessed to the satisfaction of the strategic director of finance and governance.

Senior officer teams exist within directorates to monitor the delivery of the directorate capital programme. Directorate management teams must consider and recommend all additions, variations to their directorate capital programme before being agreed by the strategic director of finance and governance and then by cabinet.

4. SHORT, MEDIUM AND LONG-TERM CAPITAL PLANNING OBJECTIVES

The council maintains an approved capital programme that covers a ten year period subject to a minimum four yearly refresh at Council Assembly and annual update by Cabinet.

The capital programme for the council is a long term ambition, with the lifetime of new and existing assets stretching far into the future. The obligation for maintaining and improving council dwellings and operational buildings is very long term and as such should be considered accordingly in financial and asset management planning.

The application and planning for the capital expenditure obligations and objectives for the council can be considered over short, medium and long term time horizons.

<u>Short to medium term (1-3 Years)</u>

Within a shorter timeframe the focus of the capital strategy is towards the delivery and implementation of any capital scheme. At this stage, the management of potential risks in the acquisition or delivery of particular capital schemes is of significant importance for the council.

Within the short term timeframe the capital programme may be amended with the introduction of urgent, high priority capital schemes. The programme will need to be flexible to ensure that the capital programme can incorporate schemes to meet the requirements or opportunities that arise. As part of capital programme and resource management, schemes may be phased over multiple years due to factors such as complexity, resourcing, legal and planning requirements.

Medium to long-term (4-10 Years)

There is typically a long lead time from identifying investment need or opportunity and to implementation. The medium term programme allows the council to develop plans for the delivery and funding across capital projects as well as the contribution of this capital expenditure toward council objectives and individual service priorities.

Early evaluation can be developed to allow the council to assess the expected benefits and costs of capital expenditure. The identification of sources of funding, specific grants, external contributions or revenue budget may be identified to fund capital projects.

The council incorporates the capital programme expenditure and funding projections into medium term cashflow forecasting which in turn feeds into the debt management strategy for the council. Decisions on debt financing will be influenced by capital projections as well as forecast capital receipts.

The ten year capital programme and the implications of the programme for MRP and debt financing costs are incorporated into the medium term financial strategy.

Long Term: 10 Years Plus

The council is currently preparing its New Southwark Plan, a new borough-wide planning and regeneration strategy up to 2033. Once finalised and adopted, it will replace the current local plan.

The council is able to review and develop strategies for meeting investment need in the much longer term where there is considerable uncertainty and complexity, for example understanding economic, social and technological factors that drive regeneration and redevelopment initiatives, long-term planning issues to deliver objectives e.g. the council's ambition to deliver new homes; the rolling HRA business plan which looks to identify over a very long term time horizon the likely financial and housing need provision for the HRA; the joint strategic needs assessment for social care; pupil planning data for the future provision of school places; asset management planning for long-term property need and investment.

There is a clear link between long term planning for capital and for treasury management purposes. The council's debt portfolio contains loans that mature up to 2057-58. The debt repayment profile needs to be managed alongside the longer term expectations for capital expenditure and funding forecasts.

Long-term forecasts are not easily predicted and the accuracy of all financial estimates will be limited. However, long-term forecasting is valuable in informing strategic plans taking account of the cumulative sustainability and affordability of existing and planned investment, which will need to be repaid over future periods. For major projects and investment the funding and financial implications need to be planned well in advance.

5. COUNCIL PLAN CAPITAL INVESTMENT PRIORITIES

Capital investment plans are driven by the Council Plan, the council's key strategic document that sets out the council's vision, ambitions, values and priorities. A refreshed Council Plan is currently being consulted on and will be presented to Council Assembly for approval in the autumn. Key capital commitments in the draft Council Plan include:

- to build more council houses and secure new homes at London Living Rent
- to build a new library and GP health centre on the Aylesbury estate
- to open a new, modern leisure centre at Canada Water
- to open a new secondary school at Borough
- to build a new library on the Walworth Road
- to open a new library at Grove Vale in East Dulwich
- to work with the Mayor of London to build a new pedestrian and cycling bridge from Canada Water to Canary Wharf
- to deliver new affordable business spaces
- to open two nursing homes
- to build extra care housing

6. ASSET MANAGEMENT PLANNING

The overriding objective of asset management within the council is to achieve a corporate portfolio of property assets that is appropriate, fit for purpose and affordable. The council's property portfolio consists of operational property, investment property and property held for specific community or regeneration purposes. The council has specific reasons for owning and retaining property:

- Operational purposes e.g. assets that support core business and service delivery e.g. schools, office buildings.
- Investment properties held to provide a financial return to the council that supports service provision.
- Parks, playgrounds and open spaces.
- Regeneration, enabling strategic place shaping and economic growth.

Asset management is an important part of the council's business management arrangements and is crucial to the delivery of efficient and effective services, the ongoing management and maintenance of capital assets will be considered as part of the strategy. The asset management planning includes an objective to optimise the council's land and property portfolio through proactive estate management and effective corporate arrangements for the acquisition and disposal of land and property assets.

The council will continue to realise the value of any properties that have been declared surplus to requirements in a timely manner, having regard to the prevailing market conditions.

7. COMMERCIAL ACTIVITY AND INVESTMENT PROPERTY

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines investment property as property held solely to earn rentals or for capital appreciation or both. Returns from property ownership can be both income driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth). The combination of these is a consideration in assessing the attractiveness of a property for acquisition.

In the context of the Capital Strategy, the council is using capital to invest in property to provide a positive surplus/financial return. The council may fund the purchase of the property by borrowing money, normally from the Debt Management Office as part of HM Treasury. The rental income paid by the tenant should exceed the cost of repaying the borrowed money each year. The annual surplus then supports the council's budget position, and enables the council to continue to provide services for local people.

The reasons for buying and owning property investments are primarily

- Financial returns to fund services to residents
- Market and economic opportunity.
- Economic development and regeneration activity in the Borough (all investment property is currently located within Southwark)

Historically, property has provided strong investment returns in terms of capital growth generation of stable income. Property investment is not without risk as property values can fall as well as rise and changing economic conditions could cause tenants to leave with properties remaining vacant.

The strategy makes it clear that the council will continue to invest prudently on a commercial basis and to take advantage of opportunities as they present themselves, supported by our robust governance process.

8. LOANS

The council has discretion to make loans for a number of reasons, primarily for economic development. These loans are treated as capital expenditure.

In making loans the council is exposing itself to the risk that the borrower defaults on repayments. The council, in making these loans, must therefore ensure they are prudent and has fully considered the risk implications, with regard to both the individual loan and that the cumulative exposure of the council is proportionate and prudent.

The council will ensure that a full due diligence exercise is undertaken and adequate security is in place. The business case will balance the benefits and risks. All loans are agreed by Cabinet. All loans will be subject to close, regular monitoring.

9. REVENUE BUDGET IMPLICATIONS FROM CAPITAL INVESTMENT DECISIONS

Capital expenditure for the council is financed through a variety of sources, typically

- Receipts from the sale of capital assets
- Capital grants
- External contributions such as S106 or Community Infrastructure Levy
- The use of reserves or from revenue budget contributions

Any capital expenditure not financed by the above will need to be funded by borrowing. Existing council debt is therefore the consequence of historical capital expenditure. The council can temporarily utilise other resources in lieu of external borrowing to fund capital expenditure. This is referred to as internal borrowing.

In approving the inclusion of schemes and projects within the capital programme, the council ensures all of the capital and investment plans are affordable, prudent and sustainable. In doing so the council will take into account the arrangements for the repayment of debt, through a prudent MRP policy in line with MRP guidance produced by the Ministry of Housing, Communities and Local Government.

The capital financing charges and any additional running costs arising from capital investment decisions are incorporated within the annual budget and medium term financial plans. This enables members to consider the consequences of capital investment alongside other competing priorities for revenue funding.

As part of the appraisal process, and at the discretion of the Strategic Director of Finance and Governance, the financing costs of prudential borrowing, may be charged to directorate budgets.

Long Term revenue implications of capital investment decisions

Capital investment decision making is not only about ensuring the initial allocation of capital funds meets the corporate and service priorities but ensuring the asset is fully utilised, sustainable and affordable throughout its whole life. This overarching commitment to long term affordability is a key principle in any capital investment appraisal decision. In making its capital investment decisions the council must have explicit regard to consider all reasonable options available.

10. RISK APPETITE

This section considers the council's risk appetite with regard to its capital investments and commercial activities, i.e. the amount of risk that the council is prepared to accept, tolerate, or be exposed to at any point in time. It is important to note that risk will always exist in some measure and cannot be removed in its entirety.

A risk review is an important aspect of the consideration of any proposed capital or investment proposal. The risks will be considered in line with the risk management strategies we have in place and commensurate with the council's low risk appetite.

Subject to careful due diligence, the council may consider a moderately higher level of risk for strategic initiatives, where there is a direct gain to the council's revenues or the ability to deliver its statutory duties more effectively and efficiently.

11. KNOWLEDGE AND SKILLS

The council has professionally qualified staff across a range of disciplines including finance, legal and property that follow continuous professional development (CPD) and attend courses on an ongoing basis to keep abreast of new developments and skills.

The council establishes project teams from all the professional disciplines from across the council as and when required. External professional advice is taken where required and will always be sought in consideration of any major commercial property investment decision.

Internal and external training is offered to members to ensure they have up to date knowledge and expertise to understand and challenge capital and treasury decisions taken by the strategic director of finance and governance.

Annex A

CORE PRINCIPLES UNDERPINNING THE CAPITAL PROGRAMME

In considering schemes for inclusion in the capital programme, regard will be had to the following principles:

- schemes to be included in the Capital Programme should follow an appropriate level of due diligence and assurance regarding deliverability/practicable
- prior to mobilisation, all projects should be supported by an affordable and sustainable plan, including carefully consideration of value for money and options appraisal
- capital appraisal should promote schemes which provide a direct gain to the council's revenues within agreed risk appetite, e.g. council tax and business rate growth, commercial investment return, "invest to save" outcomes
- environmental and social sustainability issues should be built into project appraisal
- the financial implications of capital investment decisions will be properly appraised as part of the determination process
- available resources will be identified for investment over the capital planning period
- available capital funding will be optimised e.g. through surplus asset disposal strategy, maximising use of planning gain, by corporately pooling capital receipts and by exploring external financing sources
- that capital funding decisions minimise or mitigate the ongoing revenue implications of capital investment decisions
- the financial implications of capital investment decisions should be fully integrated into revenue budget and longer term financial plans
- robust governance arrangements are in place for all programmes and projects, clearly defining responsibility for the delivery of individual schemes within the capital programme
- all capital schemes follow appropriate project management arrangements
- there are effective working relationships with partners
- that projects are reviewed on completion to ensure key learning opportunities are maximised

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NOTE: Original held by Constitutional Team; all amendments/queries to Virginia Wynn-Jones Tel: 020 7525 7055

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