

Item No: 2.3	Classification: Open	Date: 23 February 2022	Meeting Name: Council Assembly
Report title:		Capital Strategy and Treasury Management Strategy 2022-23	
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.

That council assembly approves:

2. The Capital Strategy 2022-23 at Appendix A.
3. The Treasury Management Strategy Statement 2022-23 at Appendix B
4. The Investment Management Strategy 2022-23 at Appendix C
5. The Minimum Revenue Provision Statement 2022-23 at Appendix D
6. The Prudential Indicators for 2022-25 at Appendix E

BACKGROUND INFORMATION

7. Southwark council has a long tradition for investing 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.
8. 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.

9. Treasury management is the management of the authority's cash flows, borrowing and investments. The council is exposed to financial risks from treasury management activities including possible losses associated with council investment and the 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.
10. Since 2019-20, the council has been 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.
11. The ongoing impact on the UK from coronavirus, combined with higher inflation, higher interest rates and the country's trade position post-Brexit, will remain major influences on the Authority's treasury management strategy for 2022-23.
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. Since 2017-18 however, it has been necessary to borrow to finance the capital programme and maintain minimum cash balances.
16. In the financial year to 31 March 2021, the council borrowed £65m from the PWLB (£20m @ 1.97% £20m @ 1.96% and £25m @ 1.87% with maturity terms of 45, 46 and 49 years respectively).

17. In December 2021, the council borrowed a further £50m of long-term debt from the PWLB (20m @ 1.60% £20m @ 1.58% and £10m @ 1.57% with maturity terms of 39, 40 and 41 years respectively).
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 December 2021 was £197m. The weighted average rate of interest for current short-term debt held by the council as at 31 December 2021 is 0.1%.
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.
20. Projections for this capital expenditure and financing, as well as long term cash flow forecasts, indicate that the council may require £1bn of additional borrowing by the end of 2025.

Public Works Loan Board

21. With the exception of £7m of long-term debt from the Mayor of London's Energy Efficiency Fund (MEEF), all historical long-term debt for the council have been drawn from the PWLB. Future borrowing could come from a variety of different sources including banks, other financial institutions and local authorities but the PWLB remains the council's preferred lender. Any borrowing decision will be made in consideration of capital and cash flow 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.
22. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The council intends to avoid this activity in order to retain its access to PWLB loans.

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 (MHCLG) now rebranded Department for Levelling Up, Housing and Communities (DLHC).
24. The annual investment management strategy 2022-23 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 2022-23 the council has taken advice from the external treasury advisor, 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 Bank of England recently increased the base interest rate from 0.1% to 0.25% in December 2021. With inflation currently above 5%, and expected to reach 6% in April, gradual interest rate rises could be on the cards for 2022. Arlingclose is forecasting that Bank of England Bank Rate will rise to 0.5% between January and March 2022 and then stabilise. The risks to this forecast are judged to be initially weighted to the upside, but becoming more balanced over time.
27. The investment strategy for the council for 2022-23 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

28. 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 guidance issued by MHCLG in 2018.
29. 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.
30. 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.
31. 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

32. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance and 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.
33. The indicators for approval relate to 2022-23 to 2024-25 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 Governance

34. 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.
35. 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.
36. 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.
37. 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.

38. 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 2022-23 to 2031-22
Appendix B	Treasury Management Strategy 2022-23
Appendix C	Annual Investment Management Strategy 2022-23
Appendix D	Annual Minimum Revenue Provision Statement 2022-23
Appendix E	Prudential Indicators - 2022-25

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Tim Jones - Departmental Finance Manager	
Version	Final	
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Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	Comments Sought	Comments Included
Director of law and governance	Yes	Yes
Strategic director of finance and governance	N/A	N/A
Cabinet Member	Yes	Yes
Report sent to constitutional team	1 February 2022	