APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2024-25

Introduction

1. Treasury management is the management of the authority's cash flows, borrowings 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 a crucial part of the financial management and governance arrangements of the council.

2. Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the council to approve a treasury management strategy before the start of each financial year. This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. Investments held for service purposes or for commercial profit are considered in the capital strategy.

4. Under financial delegation, the Strategic Director of Finance 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.

Borrowing Strategy, Debt Management and Net Borrowing Position

5. As at 31 December 2023, the council held £1,065m of external borrowings (£889m at 31 December 2022) and £169m of investments (£202m at 31 December 2022).

6. The council has an ambitious capital programme, to support the wide range of services it provides and to build much-needed new council homes. In the past, revenue balances have been utilised to forestall the need to borrow externally. This approach is commonly known as internal borrowing. Internal borrowing is cheaper than external borrowing and remains the preferred source of financing in the short term whilst sufficient funds are available.

7. In September 2017 however, officers reported to cabinet that from 2017-18 onwards there would be an increasing need to borrow externally. Since then, external borrowing has gradually increased, both as a proportion of capital funding and in absolute terms. This has been necessary because of the scale of the capital programme.

8. Southwark has one of the highest outstanding Public Works Loans Board (PWLB) debt of all English councils. This is largely as a consequence of the size of Southwark's council housing estate and its position as the fourth largest social landlord in the country. This ranking is likely to rise based on the additional borrowing that will be required in coming years to fund the capital programme.

9. The most significant part of that programme remains new homes. For 2023-24, year to date, approximately £179m of external borrowing need has been identified to fund the New Homes Programme and a further £505m has been earmarked as the sum that could be borrowed within prudential code and affordability limits. This amounts to £684m in total for new homes. This provision is being constantly reviewed, especially in the context of interest rate rises, rent caps and inflation.

10. The need to borrow externally has a revenue impact, and this is accounted for annually in the council's budget setting process, both for the Housing Revenue Account (HRA) and the General Fund (GF).

11. The council could borrow from the PWLB, financial institutions and banks or directly from other local authorities.

12. Alternative sources of borrowing to the PWLB will be considered to ensure the lowest available rates are achieved and value for money is achieved for taxpayers. In the context of its efforts to address climate change, Council Assembly, in November 2023 approved the use of a Community Municipal Investment (CMI) opportunity as a borrowing option. This will support the delivery of projects within the council's climate action plan.

13. The council can raise capital via the issuance of Green Bonds or other similar peer-to-peer (P2P) loan agreements, known as Community Municipal Investments (CMI).

14. A CMI is a simple, low cost and proven way for councils to raise funding for projects that contribute to achieving net-zero carbon. Through partnership with Abundance Investment, a crowdfunding web platform is established that allows investment in a safe and secure manner.

- Green bonds issuance is a new scheme which gives residents the opportunity to invest in sustainable projects and green initiatives within the local community to support the council's target of becoming a net zero Council by 2030. Southwark's Green Investment aims to raise capital to help fund a range of green projects within the council's capital programme.

- The process is designed to offer the council a rate lower than the PWLB at the time of launch, while also offering investors a commercially viable opportunity, paying back at an agreed interest rate every six months over a five year period. Investors also have the opportunity to pay back all or part of their interest to the council at the end of the loan period, to further invest in green projects. This secures the funding for the council at a cheaper rate than borrowing publically from the PWLB and offers a low risk return for investors. CMIs therefore create engagement opportunities for councils with their local communities, while diversifying funding sources.

- In recent years, various councils have successfully launched CMIs and secured their funding target for investment in projects improving environmental and social impact, most council's to date focusing on building retrofit, installation of solar panels, electric vehicle charging and fleet upgrades.

- CMIs have varied in value from £1m (in a single issue on a standalone basis) to £5m to be issued over multiple tranches/investment phases.

15. The council's chief objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving certainty over the period for which funds are required.

16. Whilst internal borrowing and short term borrowing provide a low cost interim solution, they effectively defer inevitable long-term borrowing into subsequent periods. As near-term rate cuts seem unlikely, the strategy for 2024-25 is to borrow externally when rates are favourable. The exact timing and amount will be determined by the Strategic Director of Finance and with regard to advice from our external treasury advisors.

Balance Sheet Summary

17. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), whilst usable reserves and working capital are the underlying resources available for investment. The council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing.

18. The council has an increasing CFR due to its ambitious capital programme. Based on current forecasts, there is an estimated need to borrow up to £824m (£1.7bn less £0.9bn) by 31 March 2027.

	2022-23 Actual £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
General Fund CFR	788	780	988	1,007	1,006
HRA CFR	704	921	1,085	1,181	1,240
Total CFR	**1,492**	**1,701**	**2,074**	**2,189**	**2,245**
Less: Other debt liabilities	76	71	176	171	166
Loans CFR	**1,416**	**1,630**	**1,898**	**2,018**	**2,079**
Less: External Borrowing - Actual	991	1,066	947	914	877
Internal Borrowing / (Over Borrowing)	**425**	**564**	**951**	**1,104**	**1,202**
Less: Usable reserves	376	343	323	300	283
Less: Working capital	269	269	269	269	269
(Investments) / New Borrowing	**-220**	**-48**	**359**	**535**	**651**

Liability Benchmark

To compare the council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing.

19. The liability benchmark is effectively the net borrowing requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow.

20. CIPFA recommends that the optimum position for external borrowing should be at the level of the liability benchmark (i.e. all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely, where external loans exceed the liability benchmark, this will highlight an over-borrowed position which will result in excess cash in the organisation requiring investment, thus exposing the authority to credit and reinvestment risks and a potential cost of carry.

21. From the table below, this liability benchmark requires that cash and investment balances are kept to a minimum level of £65m at the end of 2023-24. This amount includes the council's external fund managers' portfolio of approximately £25m, and an internally managed cash balance of £40m to maintain sufficient liquidity. The risks identified will then have to be managed over the coming years.

Liability Benchmark (£m)	2022-23 Actual £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
Loans CFR	**1,416**	**1,630**	**1,898**	**2,018**	**2,079**
Less: External Borrowing*	991	1,066	947	914	877
Internal Borrowing / (Over Borrowing)	**425**	**564**	**951**	**1,104**	**1,202**
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Net Borrowing Requirement	771	1,018	1,306	1,449	1,528
Minimum Investment Balance	140	65	52	43	40
Liability Benchmark: Year-End	**911**	**1,083**	**1,358**	**1,492**	**1,568**

**Shows only loans to which the council is committed*

22. The liability benchmark suggests the council will require a minimum level of borrowing in 2024-25 of £275m (£1,358m in 2024-25 less £1,083 in 2023-24), to maintain the minimum investment level of £52m at year-end. The actual level of borrowing at year-end depends on whether the council's spending plans proceed as planned and on the actual timing of borrowing.

Investment Position and Activity

23. The council holds sizeable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investment balances as at 31 December 2023 were £169m.

24. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the Department of Levelling Up and Housing and Communities (DLUHC) Guidance on Local Authority Investments and the council's approved investment strategy. The guidance gives priority to security and liquidity and the aim is to achieve a yield commensurate with these principles.

25. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and other highly secure, liquid financial instruments.

26. Any surplus cash resources not required in the short-term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

27. The externally managed investment portfolio totalled £100m until July 2023, when the decision was made to disinvest principal amounts on maturity, in order to reduce the council's borrowing requirement. As at 31 December 2023, the total market value of the portfolio stood at £49m.

28. The distribution of council investments across counterparties by rating and maturity as at 31 December 2023 is set out in the table below:

Investment Maturity Profile and Credit Ratings

	A		AA		AAA		Total	
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**	**%**
Up to 1 Year	13.9	8.2	17.5	10.3	125.5	74.1	156.9	92.6
1-2 Years	2.1	1.3	2.0	1.2	5.4	3.2	9.5	5.6
2-5 Years	2.0	1.2	0.0	0.0	1.0	0.6	3.0	1.8
Total	**18.0**	**10.6**	**19.5**	**11.5**	**131.9**	**77.9**	**169.4**	**100.0**

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

29. The Bank of England Base Rate rose from 0.75% in April 2022 to 5.25% in September 2023. Rates were then held at 5.25%, ending a run of fourteen consecutive rises after inflation started to slow down. Market expectation is that interest rates will peak at this level.

30. The council's treasury management adviser, Arlingclose, is forecasting that the Bank of England Base Rate will peak at 5.25% and that the MPC will cut rates in the medium term to stimulate the UK economy with rate cuts from quarter 3 2024 to a low of around 3% by early 2026.

31. To analyse the treasury management portfolio, the council measures the return against a composite investment benchmark of three-month SONIA (Sterling Overnight Indexed Average) and one to three year gilt index.

32. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by DLUHC.

33. The priorities for treasury management investment are, in order of priority, security, liquidity and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due.

34. It is important that the treasury management strategy is suitably flexible, such that the council can take advantage of market opportunities and maintain appropriate asset diversification within the portfolio to best support the council's revenue budget, whilst retaining the overriding objectives of security and liquidity.

Environmental, Social and Governance (ESG) considerations

35. Environmental, social and governance (ESG) considerations are becoming increasingly important in investment decision making. The council strongly believes that integrating climate change and other ESG factors into the investment philosophy will protect and improve the risk profile of its investments over the long term.

36. Approaches to ESG investments and related data collecting and reporting are still evolving. The council will work continuously towards adopting latest guidelines and industry best practice in its approach to ESG aspects of its investments.

37. The council will review investment managers to ensure sound ESG practices, such as ESG disclosures, signatory to various ESG initiatives and standards, external assurance on ESG disclosures, or are actively developing/evolving their approach, allowing the accommodation of managers at different stages in their responsible investment journey.

38. The council's approach will evolve as more progress is undertaken on ESG reporting and as new wider ESG-focused products/funds become available.