Item No: 9.	Classification: Open	Date: 21 November 2018	Meeting Name: Audit, Governance and Standards Committee
Report title:		Capital Strategy and Treasury Management Strategy 2019-20	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATIONS

That audit governance and standards committee note the draft:

i. Capital Strategy 2019-20 (Appendix A)

ii. Treasury Management Strategy Statement 2019-20 (Appendix B)

iii. Investment Management Strategy 2019-20 (Appendix C)

iv. Minimum Revenue Provision Statement 2019-20 (Appendix D)

v. Prudential Indicators for 2019-2021 (Appendix E)

BACKGROUND INFORMATION

1. Each year council assembly agrees an annual treasury management strategy, covering the management of council debt and cash investments.

2. 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 is a crucial part the financial management and governance arrangements of the council.

3. For 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.

4. 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

Local Authority Regulatory Changes

Revised CIPFA Codes

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

6. In the 2017 Treasury Management Code the definition of 'investments' has been widened to include additional financial and 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.

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

8. 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.

9. 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. The Code also expands on process and governance issues associated with capital expenditure and investment decisions.

10. The requirement to produce a capital strategy as per the 2017 Prudential Code is effective from April 2019. However the council elected to produce an early version of the capital strategy, which was agreed by Council Assembly in July 2018 in advance of this deadline, in order to ensure early consideration of the strategy and the context in which capital and investment decisions are made.

MHCLG Investment Guidance and Minimum Revenue Provision

11. In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) 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.

12. 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).

13. 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.

14. The Guidance introduces the concept of proportionality and 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.

15. As at 31 March 2018 the value of investment properties owned by the council (General Fund and HRA) is £232m. 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.

16. 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.

17. 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.

18. 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.

19. The Council’s existing MRP policy and proposed MRP Policy for 2019-20 (Appendix D) is compliant with the new guidance.

Budget 2018 and HRA Debt Cap

20. As part of the 2018 UK National Budget on 29 October 2018 the debt cap for the HRA has been lifted with immediate effect. As at 31 March 2018 the HRA had £147m headroom within the debt cap.

21. The capital programme for the HRA will continue to comply with the requirements of the CIPFA prudential code; such that capital expenditure and any associated financing implications must be affordable, prudent and sustainable.

22. The setting of internal prudential borrowing limits for the HRA will be required such that the annual cost of financing debt remains affordable. Any prudential limit is expected to be significantly greater than the national debt cap. Initial estimates indicate that a prudential borrowing cap for affordability for the HRA borrowing could be up to £1,300m, increasing the headroom for new borrowing to around £900m, over the long term.

23. The potential to increase prudential borrowing within the HRA will allow the council to consider opportunities for ambitious housebuilding schemes that

would otherwise have been excluded due to the limitations enforced by the debt cap.

Borrowing strategy and debt management activity and position

24. 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 temporarily fund capital expenditure rather than the use of external borrowing.

25. 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

26. 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. At 31 March 2018 the council had external debt of £110m in short term loans from other local authorities.

27. This approach to short term borrowing has continued into the first half of 2018-19 with the balance of short term borrowing from local authorities at £145m as at 30 September 2018. The weighted average rate of interest on short term borrowing is 0.90%, significantly less than long-term rates of borrowing.

28. Future borrowing requirements arising from the approved capital programme, the extent of internal borrowing and the need to refinance scheduled debt repayments, together with potential for interest rate rises, indicate the need for long-term borrowing during the second half of 2018-19, with further borrowing required during 2019-20.

29. Projections for approved capital expenditure and cashflow indicate an additional borrowing requirement of up to £250m by March 2019.

Proposed Investment Strategy

30. The council's investment objectives are to preserve principal, provide liquidity and secure a return on investment consistent with the prior objectives of security and liquidity. This is in line with investment guidance produced by the Ministry of Communities and Local Government

31. The annual investment management strategy 2019-20 is attached at Appendix C. The strategy will allow investment access to 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.

32. In considering the investment strategy for 2019-20 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.

33. The investment strategy for the council for 2019-20 is proposed to remain broadly 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. The proposed changes to the strategy are set out in Appendix B.

Minimum Revenue Provision (Appendix D)

34. Each year, the General Fund sets aside sums known as the minimum revenue provision 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.

35. 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.

36. 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.

37. 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 (Appendix E)

38. 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. The indicators needing approval relate to 2019-20 to 2021-22 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 his financial responsibilities in this area.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

39. 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.

40. 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.

41. 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.

42. 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.

43. 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 2019-20 to 2028-29
Appendix B	Treasury Management Strategy 2019-20
Appendix C	Annual Investment Management Strategy 2019-20
Appendix D	Annual Minimum Revenue Provision Statement
Appendix E	Prudential Indicators - Recommended for Approval

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance		
Report Author	Alex Moylan, Senior Finance Manager		
Version	Final		
Version Date	9 November 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		N/A	N/A
Cabinet Member		Yes	Yes
Report sent to Constitutional team			9 November 2018