Lambeth

Treasury Management and Capital Strategy and Prudential Indicators 2021/22 to 2024/25

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1. Treasury Management - Introduction and scope

1.1. The Chartered Institute of Public Finance and Accountancy (CIPFA) has defined treasury management as “the management of the organisations’ investments and cash flow, its banking, money market and capital market transactions; the effective control of the risks associated with these activities and the pursuit of optimum performance consistent with those risks.

1.2. Treasury management activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). 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 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This Appendix fulfils the Council’s legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3. This Treasury Management Strategy considers the impact of the Council’s revenue budget and capital programme on the balance sheet position, the prospects for interest rates, borrowing requirement and strategy, debt management, investment strategy and policy, monitoring, members training and advisors.

1.4. The Treasury Management Strategy incorporates a debt management strategy that reflects the Council’s potential need to borrow to finance its capital expenditure plans as set out in Appendix 6.

1.5. The Prudential Indicators set out in this appendix have been formulated on the basis that additional long-term borrowing may be undertaken to fund the capital investment programme in addition to capital receipts, grants, other contributions and cash balances.

1.6. The Council uses Link Asset Services as its external treasury management consultant. Whilst this arrangement gives the Council access to specialist skills and resources, it should be remembered that the responsibility for treasury management rests with the authority and that external service providers are supporting the authority’s treasury management function

2. Economic Outlook

2.1. The Bank of England’s Monetary Policy Committee kept the Bank Rate unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown which is forecast to put back economic recovery and do further damage to the economy. The Bank announced a further tranche of £150bn of quantitative easing (QE) in addition to the £300bn announced between March and June 2020, in order to support the economy and help to ensure the unavoidable near-term slowdown in activity is not amplified by a tightening in monetary conditions that could slow the return of inflation to the target.

2.2. Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022
- The Bank also expects there to be excess demand in the economy by Q4 2022.
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

2.3. Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.

2.4. One key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". This seems to indicate that even if inflation rises to 2% in a couple of years' time, there will be no action from the MPC to raise the Bank Rate until it can be clearly seen that the level of inflation is going to be persistently above target unless it takes action to raise the Bank Rate.

2.5. However, the minutes did contain several references to downside risks. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also stated, "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too.

2.6. As for upside risks, economic and political commentators were waiting expectantly for news that various COVID19 vaccines would be cleared as being safe and effective for administering to the general public. The recent announcements and rollout of vaccines has provided confidence.

<u>Brexit</u>

2.7. The final agreement on 24 December 2020, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis.

<u>Interest rate forecasts</u>

2.8. For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.10%, and the base assumption is that new borrowing will be undertaken anytime the need arises to fund the Capital investment programme. The following table gives the interest rate forecast provided by the council's treasury adviser and is their central view.

Table 1

Interest Rate Forecast – November 2020

	Bank Rate	3-month London Interbank Bid Rate (LIBID)	12-month London Interbank Bid Rate (LIBID)	25-year PWLB rates	50-year PWLB rates
Mar-21	0.10	0.10	0.20	1.50	1.30
Jun-21	0.10	0.10	0.20	1.60	1.40
Sep-21	0.10	0.10	0.20	1.60	1.40
Dec-21	0.10	0.10	0.20	1.60	1.40
Mar-22	0.10	0.10	0.20	1.60	1.40
Jun-22	0.10	0.10	0.20	1.70	1.50
Dec-22	0.10	0.10	0.20	1.70	1.50
Jun-23	0.10	0.10	0.20	1.80	1.60

2.9. The table below shows the lowest, average, and highest annual medium-term forecasts for the official Bank rate by independent forecasters compiled by HM Treasury.

Table 2

HM Treasury Survey of Forecasts – November 2020					
	Average Annual Bank Rate %				
	2020	**2021**	**2022**	**2023**	**2024**
Highest	0.23	1.90	4.50	5.00	5.00
Average	0.17	0.24	0.49	0.71	0.89
Lowest	0.10	0.02	-0.10	-0.06	0.07
OBR Central Economic Scenario	0.19	0.00	0.04	0.11	0.17

3. Investment Strategy

3.1. The Council holds surplus funds, representing income received in advance of expenditure plus balances and reserves. In the past 12 months, the Council's investment balance has ranged between £10.2 million and £60.2 million, and average balances are expected to be in this same range in the forthcoming year. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

3.2. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

3.3. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and it has sufficient liquidity in its investment.

3.4. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

- In order to limit risk in the case of a single default, the maximum that will be lent to any one external organisation(other than the UK Government and the Council's Bankers) will be £30 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

<u>Investment criteria and limits</u>

3.5. The Council defines the following as being of "high credit quality" (as per the MHCLG Guidance), subject to the monetary and time limits shown.

Table 3

Investment Criteria and Limits		**Counterparty Rating Cash limit**	**Time limit**
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£25m each of which no more than £20m over 1 year	5 years
	AA+		
	AA		4 years
	AA-		3 years
	A+		2 years
	A	£20m each	1 year 6 months
	A-		
	BBB+	£10m each	1 year
UK building societies whose lowest published long-term credit rating is BBB and societies without credit ratings with assets greater than £500m		£10m	1 year 6 months
UK building societies whose lowest published long-term credit rating is below BBB and/or societies without credit ratings with assets less than £500m but greater than £250m		£5m	1 year
Money Market Funds and similar pooled vehicles whose lowest published credit rating is AAA		1.0% of the Funds size	Instant Access
Other non-credit rated pooled investment vehicles such as property funds		£30m	notice period
Pooled Bond Funds		£1m	notice period
UK Local Authorities (irrespective of credit rating)		£25m each	25 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is [**A-**] or higher		£20m each	10 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is [**BBB-**] or higher and those without credit ratings		£10m each	5 years
UK Central government and its agencies (irrespective of credit rating)		unlimited	unlimited
Organisations funded through the Funding Circle Targeted at local businesses within the Council area.		£100,000	5 years

3.6. The Council's current accounts are held with RBS/National Westminster Bank only. The Council will treat RBS Natwest as "high credit quality" for the purpose of making investments as per criteria set out in table 3.4.1 below, although amounts in excess of the above criteria will be held in the general fund bank accounts and instant access accounts for the Council's operational purposes. RBS NatWest as the Council's provider of banking services, is deemed to meet the Councils minimum criteria in terms of its investment strategy i.e. "high credit quality" for the purpose of making investments

Building societies

3.7. UK building societies without credit ratings will be considered to be of "high credit quality", but subject to a lower cash limit and shorter time limit than rated societies. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. When the Government amends the building society insolvency regime the Council will review its use of these counterparties to ensure that it continues to comply with the MHCLG investment guidance that local authorities should have regard to Security first of principal invested, then Liquidity and Yield in that order. However, no investments will be made with building societies with assets less than £250 million due to the increased likelihood of default implied by this rating.

Money market funds

3.8. Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. As part of its shadow banking regulatory proposals, the European Commission implemented a new European framework for Money Market Funds ("MMFs") that came into force in July 2018 that require these funds to segregated as below:

- Public Debt Constant Net Asset Value ("CNAV") MMFs
- Low Volatility NAV ("LVNAV") MMFs or
- Variable NAV ("VNAV") MMFs

3.9. From the description of the LVNAV these mimic CNAV and in order to manage liquidity, the Council will be inclined to invest in any of these funds as they offer same-day liquidity and as an alternative to instant access call accounts which now offer a yield of as low as 0.01%

3.10. The Council will also consider using other pooled funds such as pooled property and bond funds that offer enhanced returns over the longer term, but as these are longer term commitments, the Council would undertake due diligence and a selection process before entering such longer-term investments.

Funding Circle

3.11. As part of the 2021/22 investment criteria a small amount of funds may be invested with local companies through the peer to peer lending scheme, the Funding Circle. The inclusion of this option is part treasury management, to test whether investment returns can be boosted, and part policy to support local businesses. These investments will be classified as non-treasury investments in compliance with the new CIPFA and MHCLG guidance.

3.12. The initial investment pool is small, in order to assess the performance of this option. The Council's finance staff will undertake appropriate due diligence on the Funding Circle counterparties commensurate with the size of any loan but may seek the assistance of the Council's external treasury advisors. As with any loans of this nature there is a possibility of partial or full loss of some of the investments, although overall the Council would expect a better performance than cash investments. The performance of this option will be reported to Members in the annual treasury management report to assess whether to continue or expand the scheme.

Foreign countries

3.13. Investments in foreign countries will be limited to those that hold an AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of £25 million per foreign country. Investments in countries whose lowest sovereign rating is not AAA will be limited to one year's duration. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

3.14. Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will be classed as UK banks given the arms-length nature of the parent-subsidiary relationships.

3.15. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

Risk assessment and credit ratings

3.16. The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc. and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

3.17. Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade (except for rated building societies whose Balance Sheet size is taken into consideration). The Council will not hold speculative grade investments.

3.18. Credit ratings are obtained via a live feed from the rating agencies and monitored in conjunction with the Council's treasury advisers. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then: no new investments will be made, any existing investments that can be recalled or sold at no cost will be sold, and full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

3.19. Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

3.20. The Council's investments are normally senior unsecured liabilities of the borrower, and the credit rating of the investment is therefore normally identical to the credit rating of the counterparty. However, where a credit rating agency awards a different rating to a particular class of investment instruments, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

4. Other information on the security of investments

4.1. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

4.2. When deteriorating financial market conditions affect the creditworthiness of all organisations this is not generally reflected in credit ratings but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

4.3. If these restrictions mean that insufficient commercial organisations of "high credit quality" are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

5. Specified and Non-specified investments

5.1. The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- The making of the investment is not defined as capital expenditure
- investment is not a long-term investment and is due to be repaid within 12 months of arrangement,
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - A body or investment scheme of "high credit quality".

5.2. Any investment not meeting the definition of a specified investment is classed as non-specified investments or loans. These loans are within the scope of the statutory guidance on Local Government investments issued under section 15(1)(a) of the Local Government Act, which allows a local authority to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type, risk and duration of the loan. All loans will need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels

5.3. The Council is a partner in the Real Lettings Property Fund operated by Resonance Limited and memberships includes a number of other London authorities including the GLA, Guys and St Thomas Charity, and St Mungo's Community Housing Association. The principal activity of the Partnership is to purchase, development and letting of residential property in the Greater London area to St Mungo's to target the reduction of homelessness and provide more affordable and cost effective access to affordable accommodation for former homeless people or those at risk of homelessness, temporary accommodation. The Property Fund has a 9 year life and aims to deliver a minimum return of 5% per annum, together with share of the capital appreciation at the end of the loan term. The Council has invested £30m in the scheme and has access to 100 properties.

5.4. The Council is committed to increasing the supply of social housing across the borough and to this end has established the wholly owned Homes for Lambeth Group of companies to build and manage the development of new homes. Funding to Homes for Lambeth is provided by the Council in the form of loans at commercial rates and specific terms as per individual loan agreements and within the scope of the Memorandum of Understanding. The Council has set an upper limit of £150m for outstanding loans to HfL at any time..

5.5. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation, such as company shares.

6. Policy on Use of Financial Derivatives

6.1. Local authorities (including this Council) have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

6.2. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be considered when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7. Planned investment strategy for 2021/22

7.1. The cash flow forecast is used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows and used primarily to generate investment income.

8. Borrowing Strategy

8.1. The base assumption is that the Council will consider new borrowing to finance its capital investment programme and any other capitalised expenditure. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either borrow short-term loans, variable rate loans or to not borrow and reduce the level of investments held instead. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against the potential longer-term costs.

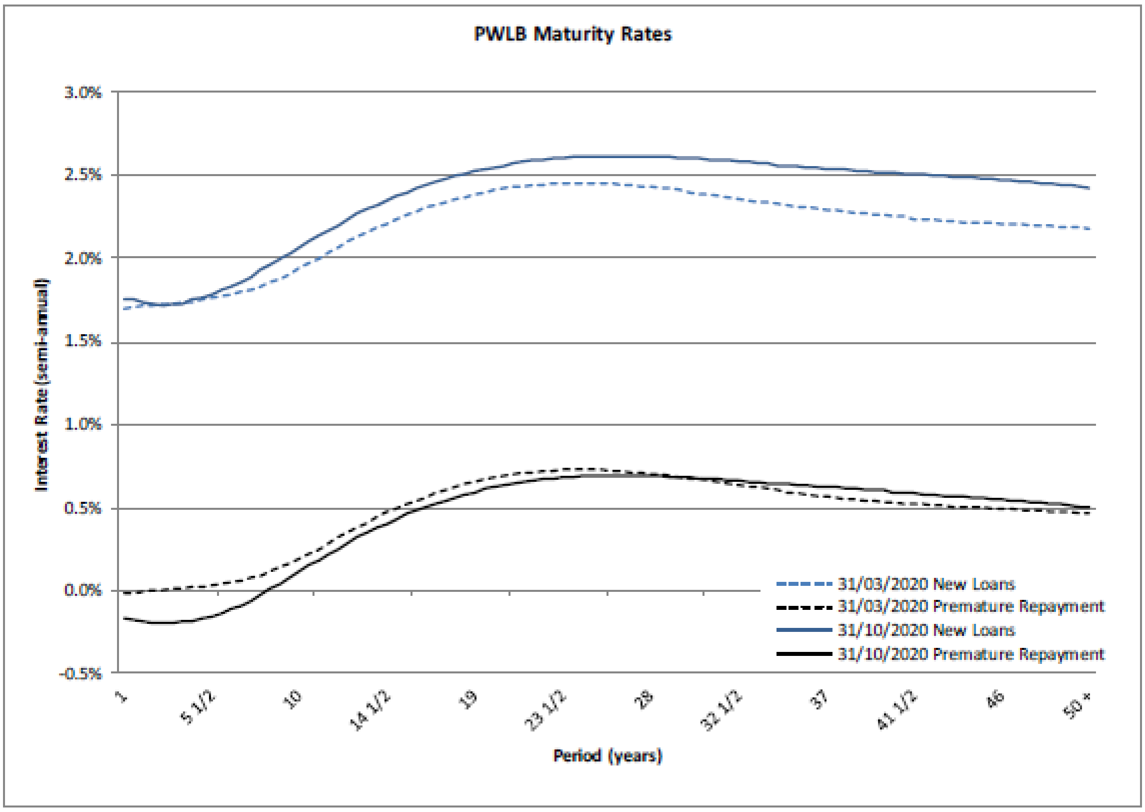
8.2. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk. However, debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2019.

8.3. The graph below illustrates the historical movement of PWLB rates in 2020/21 with an overall trend of 50-year maturity borrowing just under the 2.50% level.

8.4. Certainty Rate means the PWLB standard interest rate reduced by 20 basis points (0.20%) on loans from PWLB to principal local authorities who provide information as required on their plans for long-term borrowing and associated capital spending. The Council provides as a matter of routine.

Diagram 1

PWLB Maturity Rates (incl. Certainty Rates)



8.5. Following the HM Treasury's announcement on the 25 November of the reduction of PWLB rates by 100 basis points, the 50yr borrowing rates are at or about 1.60%.

9. Sources of borrowing

9.1. The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments above
- any other bank or building society approved by the Financial Services Authority
- capital markets
- Special purpose companies created to enable joint local authority bond issues.
- Institutional investors such as pension funds
- The Municipal Bonds Agency
- The Greater London Authority
- Other UK local authority or public sector body

10. Planned borrowing strategy for 2021/22

10.1. The cumulative capital financing requirement (CFR) or underlying need to borrow as at 31st March 2020 was £1,026.5 million. This amount comprises £591.6 million of external borrowings and £434.9 million of other internal resourcing which avoided the requirement to borrow.

10.2. The Council's CFR as at 31st March 2021 is expected to be £1,157.7 million and is forecast to go up by £183.6 million by March 2022 as capital expenditure is incurred. This will be funded from the current cash balances held and new borrowing.

10.3. The maximum expected borrowing requirement for 2021/22 is:

Table 5

Maximum Expected borrowing Requirement for 2021/22	£m
Change in underlying need to borrow	199.50
Less: Minimum Revenue Provision (MRP)	(10.80)
Less: Finance Lease Repayments and PFI's	(5.1)
Equals: Forecast increase in Capital Financing Requirement (CFR)	**183.60**
Plus: Loans matured in 2020/21	0.0
Equals: Total New borrowing requirement 2021/22	**183.60**

10.4. Depending on the pattern of interest rates during the year, it may be more cost effective to defer borrowing until later years, and to temporarily reduce the size of the Council's investment balance instead.

10.5. In addition, the Council may borrow for short periods of time (normally for up to two weeks) to cover unexpected cash flow shortages.

11. Current and Expected Treasury Portfolios

<u>Current portfolio</u>

11.1. The Council's treasury portfolio as at 31 December 2020 was a net borrowing of £576.6m as detailed in the table below. Net borrowing is expected to increase and will be achieved by reducing investment balances and additional borrowing as discussed in the borrowing strategy.

Table 5

Current Portfolio	**Principal amount £m**	**Interest rate %**
Call accounts	5.1	0.10
Money market funds	0.0	0.00
Short-term deposits	10.0	0.80
Long-term deposits	0.00	0.00
Total Investments	**15.1**	**0.56**
Short-term loans	0.00	0.00
Long-term PWLB loans	(591.7)	4.44
Long-term market loans (LOBOs)	-	
Total Borrowing	**(591.7)**	**4.44**
Net Borrowing	**(576.6)**	

11.2. The yearly interest payable for the existing £591.7m borrowing is £26.3m at an average interest rate of 4.44%. The estimated interest payable for the remaining borrowing requirement of £225m is £3.6m per annum (based on the PWLB interest rate forecasts) on 50yr borrowing. Therefore, by 2024/25 the interest payable on total planned council debt of £817m will be £29.9m pa.

11.3. The Council is required to set aside a Minimum Revenue Provision (MRP). The current provision is set at 1.67% or 50yrs for post 2008 borrowing. MRP is calculated on the CFR, as opposed to actual borrowing so regardless of which loans are taken out within the CFR, the MRP would only grow with an actual change in the borrowing requirement that is unfinanced capitalised expenditure. The MRP over the next four years to 2024/25 is contained in the Minimum Revenue Policy Strategy Appendix 8

12. Budget implications

12.1. The balance sheet review and five year forecast to 2024/25 shows that based on the Statement of Accounts for 2019/20 the Council had an underlying borrowing requirement (CFR less Other Long-Term Liabilities (OLTL)) of £930m. The Council has PWLB borrowing of £591.7m and the Council is therefore internally borrowed by £338.4m. This means cash backing up reserves and balances and working capital has been used in lieu of external borrowing. This is both cost effective and low risk.

12.2. The balance sheet review carried out indicated that there is a borrowing requirement of £415m over the next four years ending 2024/25. All the borrowing will be for the council's capital programme and non-treasury related expenditure. The exact timing of borrowing will depend on the council's cashflow position and/or levels of interest rates. Any surplus monies held at any given time will be invested in line with the criteria set out within this strategy.

12.3. The Council's cash during 2020/21 was approximately £22m during December 2020 indicating that both the CFR and/or reserves were stable. Working Capital is assumed to stay static at £90m.

12.4. The previously approved PWLB 50 year borrowing requirement of £360m has resulted in two drawdowns. £40m was borrowed in 2018/19 and £150m was borrowed in 2019/20. The balance of £170m will be borrowed as required over the next four years. Further approval for borrowing will be requested at the appropriate time.

12.5. Any variations on actual levels of investments and borrowing, and interest rates and its implications will be reported through the Council's regular revenue monitoring process.

13. Treasury Management Indicators

13.1. The Council measures and manages its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators summarised in the table below with explanations of the indicators.

Table 6

Treasury Management Indicators	**Performance or Target**			
Indicator Description	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Borrowing Limits				
Authorised Limit	£1,441m	£1,574m	£1,604m	£1,623m

Treasury Management Indicators	**Performance or Target**			
Authorised limit – other long-term liabilities	£86m	£81m	£76m	£76m
Total Authorised Limit	**£1,528m**	**£1,655m**	**£1,680m**	**£1,698m**
Operational Limit	£1,341m	£1,474m	£1,504m	£1,523m
Operational limit – other long-term liabilities	£86m	£81m	£76m	£76M
Total Operational Limit	**£1,428m**	**1,555m**	**£1,580m**	**£1,598m**
Security: average credit rating				
Portfolio average credit rating	A-	A-	A-	A-
MHCLG Non-specified investments Limits				
Total Long-Term Investments	£50m	£50m	£50m	£50m
Investments with Building Societies rated BBB or less	£180m	£180m	£180m	£180m
Other non-credit rated Pooled Funds	£15m	£15m	£15m	£15m
Total of Funding Circle Loans	£0.1m	£0.1m	£0.1m	£0.1m
MHCLG Specified investments Limits				
Total investments in MMF*	£50m	£50m	£50m	£50m
Budgeted Investment Return				
Return on Investments	0.10%	0.10%	0.10%	0.10%
Liquidity: cash available within three months				
Total cash available without borrowing	£10m	£10m	£10m	£10m
Total cash available including borrowing	£20m	£20m	£20m	£20m
Maturity structure of borrowing				
Under 12 months	0%-20%	0%-20%	0%-20%	0%-20%
12 months and within 24 months	0%-20%	0%-20%	0%-20%	0%-20%
24 months and within five years	0%-25%	0%-25%	0%-25%	0%-25%
Five years and within 10 years	0%-75%	0%-75%	0%-75%	0%-75%
10 to 20 years	0%-75%	0%-75%	0%-75%	0%-75%
20 to 30 years	0%-100%	0%-100%	0%-100%	0%-100%
30 to 40 years	0%-100%	0%-100%	0%-100%	0%-100%
40 to 50 years	0%-100%	0%-100%	0%-100%	0%-100%
Principal sums invested for periods longer than 365 days				
Investments longer than 365 days.	£50m	£50m	£50m	£50m

13.2. The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. For the purpose of this indicator, unrated building societies are assigned an indicative rating of BBB, and unrated local authorities are assumed to hold an AA- rating.

13.3. The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period.

13.4. The Council is exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. The maturity structure of borrowing indicator helps the Council to manage this risk and avoid large concentrations of fixed rate debt maturing at the same time. The table below shows the upper and lower limits and the current position in relation to the council’s maturity of loans.

Table 7

Maturity structure of borrowing 2020-21			
	Lower Limit	**Upper Limit**	**Current Position**
Under 12 months	0%	20%	0.00%
12 months and within 24 months	0%	20%	1.52%
24 months and within five years	0%	25%	7.36%
Five years and within 10 years	0%	75%	5.71%
10 to 20 years	75%	75%	7.99%
20 to 30 years	100%	100%	8.67%
30 to 40 years	100%	100%	36.64%
40 to 50 years	100%	100%	32.11%

Interest rate exposures

13.5. A explained in 12.1 the Council is currently maintaining an under-borrowed position. This means that the CFR has not been fully funded with loan debt but also by use of internal resources (reserves and other cash balances). This strategy is prudent as investment returns are low.

13.6. Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

13.7. Any impact on borrowing arrangements will be reported to Corporate Committee as part of the routine performance reporting arrangements.

13.8. The purpose of the indicator looking at the principal sums invested for periods longer than 365 days is to control the Council’s exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end have been set at £50m in any one year.

14. Prudential Indicators 2021/22 to 2024/25

14.1. CIPFA's Prudential Code for Capital Finance in Local Authorities requires the Council to use a set of indicators and limits to provide a control framework for capital investment and treasury management decisions.

Setting the Borrowing Limits

14.2. The Council is required to set the Operational Boundary and the Authorised Limit to its external debt. External debt refers to borrowing and other long-term liabilities e.g. leasing arrangements.

14.3. Both the limits need to be consistent with the Council's plans for capital expenditure and financing and with its treasury management policy statement and practices.

14.4. Table 8 below sets out the Borrowing Limits for the years 2021/22 to 2024/25.

Table 8

Borrowing Limits	**2021/22 £m**	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**
Operational boundary (borrowing)	1,341	1,474	1,504	1,523
Operational boundary (other long-term liabilities)	86	81	76	76
Operational boundary – TOTAL	**1,428**	**1,555**	**1,589**	**1,598**
Authorised limit – borrowing	1,441	1,574	1,604	1,623
Authorised limit – other long-term liabilities	86	81	76	76
Authorised limit – TOTAL	**1,528**	**1,655**	**1,680**	**1,698**

Capital Expenditure and Affordability

14.5. The purpose of the affordability indicators is to show whether capital investment decisions are affordable and sustainable in the medium term. The key information that indicates both the affordability and sustainability of the programme are shown in the table below and are:

- Actual and estimated capital expenditure
- Actual and estimated capital financing requirement
- Actual and estimated ratio of financing costs to net revenue stream; and
- Estimated incremental impact on council tax and housing rents.

Table 9

General Fund Prudential Indicators - Affordability	**2021/22 Budget (£'000)**	**2022/23 Budget (£'000)**	**2023/24 Budget (£'000)**	**2024/25 Budget (£'000)**
Estimates of capital expenditure	253,147	220,973	188,088	163,138
Estimates of capital financing requirement ("CFR" incl. PFI's)	694,798	847,351	970,527	991,942
GF ratio of financing costs to revenue (%)	6.91%	7.91%	8.55%	8.40%
Incremental impact on band D council tax levels (£)	0.07	0.03	0.02	0.00

HRA Prudential Indicators – Affordability	2021/22 Budget (£'000)	2022/23 Budget (£'000)	2023/24 Budget (£'000)	2024/25 Budget (£'000)
Estimates of capital expenditure	70,100	50,100	50,100	50,100
Estimates of capital financing requirement ("CFR" incl. PFI's)	462,951	494,045	503,488	511,973
HRA ratio of financing costs to revenue (%)	12.82%	13.12%	13.35%	13.72%
Incremental impact on housing rents (£)	0.12	0.05	0.05	0.06
Combined Capital Financing Requirement	**2021/22 Budget (£'000)**	**2022/23 Budget (£'000)**	**2023/24 Budget (£'000)**	**2025/26 Budget (£'000)**
Estimates of capital financing requirement (CFR)	1,157,749	1,341,396	1,474,016	1,503,916

14.6. The estimates of capital expenditure indicator reflect the capital expenditure and funding plans set out in Appendices 6, plus the capitalised value and funding of relevant long-term liabilities such as PFI arrangements.

14.7. There is considerable change on the General Fund CFR for the period 2021/22 to 2024/25, this is largely due to substantial planned capital expenditure including the Redress Scheme and Homes for Lambeth. The HRA Estimates of Capital Financing Requirement increase over the period as the HRA implements its capital investment plans.

14.8. It should be noted that the CFR does not reflect the actual level of external debt. Neither does it reflect the actual capital expenditure to be incurred in these years. They are indications of the level of capital expenditure the authority plans to finance from borrowing (that is, its underlying need to borrow). The Director of Finance, as Chief Finance officer, determines how capital expenditure is financed once a year, after year-end.

14.9. The authority has a number of significant capital investment schemes in the early stages of development. The potential borrowing requirements of these schemes have now been incorporated within the CFR.

14.10. The estimated General Fund and HRA ratios are forecast to increase as the council implements its ambitious Capital Investment plans.

14.11. The incremental impact on council tax and housing rents is a key indicator of affordability since any decision to borrow to finance capital expenditure creates incremental costs to the authority, which may impact on these charges. The indicators express the cost of proposed changes in the three-year capital programme recommended in this budget report, in comparison with the council's existing commitments and current plans. It is essential to note that this indicator is not a projection of increases in council tax/housing rents over the three years. It is simply an additional tool to aid medium term financial planning.

15. Capital Strategy

15.1. The capital strategy sets out the framework in which capital projects are designed, prioritised and delivered to support the strategic aims of the council. This strategy brings together the key issues considered by Lambeth in making decisions around capital investment: governance, resources and approach to risk.

Capital Expenditure and Financing

15.2. Capital expenditure is the money spent on the maintaining, improving or acquiring assets which will last for several years and reflects the ambition and aspirations of the council.

15.3. Capital expenditure can be funded by externally provided resources such as grants and developer contribution (Section 106 or Community Infrastructure Levy) or internally held resources such as capital receipts from the disposal of surplus assets or contribution from reserves or revenue.

15.4. Any capital expenditure not met by the sources above will have to be funded from borrowing. The council will hold resources in reserve for various reasons and if projects which will pay back its investment before those reserves are required, the council can temporarily use these funds in lieu of new external borrowing. This is referred to as internal borrowing.

15.5. In recent years, Lambeth was able to rely on capital receipts and other external resources to fund the capital programme without new borrowing. The Asset Management strategy sets out the Council's approach to managing its physical estate to maximise efficiency through appropriate usage and identifying surplus properties for disposal. However, as the disposal programme has slowed down we have reviewed the approach to funding the programme with borrowing.

15.6. The council has a duty to ensure any new borrowing is affordable, prudent and sustainable. Therefore, in considering new expenditure where borrowing is required, the council will take into account the impact on revenue resources necessary for the repayment of debt through the application of the MRP policy as required by the CIPFA Prudential Code. In addition, the on-going impact on revenue budgets, including maintenance and running costs will also be taken into consideration.

Overview of Governance Processes

15.7. The Council will set the total available general fund resources for new projects and this will be reviewed annually. The figure is based on the expected level of grants, developer contributions, capital receipts and borrowing capacity with associated revenue implications.

15.8. Cabinet will allocate within the funding envelope set by Council the themes into which the Capital Investment Programme (CIP) will be set. These themes are based around an area of responsibility and/or function, for example, parks and play or cemeteries, or a priority such as clean air.

15.9. For each theme and the programme as a whole, the following factors will need to be balanced:

- How the works under the theme promote and implement aims of the Borough Plan
- How the works assist in delivering the aims of agreed strategies or fulfill funding commitments
- How the investment opens up further opportunities for Lambeth and/or its partners
- The likely funding profile for each theme, as not all funding will be equally applicable to all types of work

15.10. Each theme will be managed by a lead Director who, with the relevant Strategic Director and Cabinet Member will have the certainty to plan over a longer horizon and flexibility to shape their programme to respond to the changing environment.

15.11. In addition, we expect to continue to receive grants for projects defined by the funder such as schools devolved formula capital grant from the Department for Education and Transport for London through the Local Implementation Plan which will be added to the CIP when the allocations are known.

15.12. The Infrastructure and Capital Delivery Studio will be the centre of delivery excellence for capital projects with the skills and ability to deliver any project or programme of work. The Studio will work with asset owners across the council to ensure there is excellent forward planning of repairs, improvements, upgrades and new assets to support the Borough Plan and statutory requirements.

15.13. The CIP budget and spend information is reported on a quarterly basis to Management Board and Cabinet as well as part of the Financial Planning reports.

16. Prudence

16.1. Gross Debt and the CFR indicator are a key control over the council's borrowing activity in relation to its capital expenditure and ensures that over the medium-term net borrowing is only for capital purposes.

16.2. No difficulty is anticipated in meeting this requirement for the current or future years having taken into account current commitments, existing plans, and the proposals in the budget report. Borrowing is anticipated for now.

Table 10

Gross Debt and the CFR Indicator	**2021/22 (£m)**
Opening Borrowing	591.60
Opening Finance Leases	81.2
Opening Gross Debt	**672.80**

CFR March 2021	**1,157,749**

17. Other Matters

17.1. The MHCLG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

<u>Treasury management advisers</u>

17.2. The Council uses Link Asset Services (formerly known as Capita Asset Services) as its external treasury management advisors, having appointed them through a tender process. The contract started on 10 May 2017.

17.3. The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

17.4. Link Asset Services provides advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- Training courses.

17.5. The quality of this service is controlled by monitoring its relevance to the requirements of the authority, the speed at which requests for information are responded to and how accurate the advice is when evaluated against other independent but similar institutions.

<u>Investment training</u>

17.6. CIPFA's revised Code requires the Director of Finance to ensure that all Members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Training on treasury management is available to Members and can be tailored to their needs and should be assessed regularly to ensure knowledge and skills are maintained at appropriate levels

17.7. The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Link Asset Services and CIPFA.

Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment of money borrowed in advance of need

17.8. The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

17.9. The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link loans with particular items of expenditure.

Policy on charging interest to the Housing Revenue Account

17.10. Following the reform of housing finance as set out in the report to Cabinet on 12th September 2011 the Council is free to adopt its own policy on sharing interest costs and income between the General Fund and Housing Revenue Account (HRA). The CIPFA Code recommends that authorities state their policy on this matter each year in their treasury management strategy.

17.11. The report agreed the separation of its external loans into GF and HRA pools and the mechanism for charging interest to each revenue account based on the weighted average cost of those loans. Following ratification of the localism bill on the 28 March 2012 the remaining loans were split into a GF pool (£169.6m) and an HRA pool (£243.1m). The split at the beginning of 2019/20 was GF pool (£255.6m) and HRA pool (£336.1m).

17.12. Interest costs chargeable to the HRA for 2020/21 will be determined once the financing of the Capital Investment Programme has been completed at year end.

17.13. When measuring the HRA capital financing requirement (HRA CFR), credit arrangements in connection with PFI schemes that have been approved by the Secretary of State for Communities and Local Government are excluded. This is in line with the MHCLG Limits on Indebtedness Determination 2012 - Amending Determination 2013 (No.2) and are shown in the table below.

Table 11

HRA Limit on indebtedness	**2021/22 £m**	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**
HRA Capital Financing Requirement	462,951	494,045	503,488	511,973
Less Myatt's Field North PFI	(69,907)	(66,907)	(63,907)	(63,907)
HCFR	**393,045**	**427,138**	**439,582**	**448,067**

Other Options Considered

17.14. The MHCLG Investment Guidance and the CIPFA Code of Practice does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Adopt a narrower definition of "high credit quality" and/or shorter time limits	Interest income will be lower	Reduced risk of losses from credit related defaults
Adopt a wider definition of "high credit quality" and/or longer time limits	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income in the short/medium term depending on changes in interest rate. Repaying debt would currently include significant premium costs, which make it unattractive.	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Management Practices for Non-Treasury Investments

17.15. The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios.

17.16. The Council will ensure that all the Council's investments are covered in the capital strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

17.17. The Council will maintain a schedule, setting out a summary of existing material investments, subsidiaries, joint ventures, and liabilities including financial guarantees and the Council's risk exposure.

Annex 1 - Treasury Management Policy Statement

The Council's financial regulations require it to create and maintain a treasury management policy statement, stating the objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition
The Council defines its treasury management activities as: the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Risk management
The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into, to manage these risks.

Value for money
The Council acknowledges that effective treasury management will provide support towards the achievement of its borough priorities. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy
The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.
The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003* and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy
The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.
The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.