Mayor and Cabinet			
REPORT TITLE	Medium Term Financial Strategy 2019/20 to 2022/23		
KEY DECISION	No	**Item No.**	
WARD	All		
CONTRIBUTORS	Executive Director for Resources and Regeneration		
CLASS	Part 1	**Date:**	11 July 2018

1. EXECUTIVE SUMMARY

1.1. The Medium Term Financial Strategy (MTFS) 2019/20 to 2022/23 sets out the Council's medium term financial plan for the next four years. It includes a review of the Council's overall financial position bringing together the outturn for 2017/18, the forecast for the current financial year 2018/19, and considers prospects for 2019/20 and future years. Council services that support all major policy objectives and priorities are delivered using a range of different resources. This document sets out the Council's strategy to ensure proper financial management and control of those resources to secure efficiency.

1.2. Central Government has stated that it remains committed to long term reforms in the way councils are financed. The aim is to significantly reduce reliance on central grants and move local authorities to be self-financing. If the main Local Government grant, the Revenue Support Grant (RSG), is to be phased out then Councils will need to rely more on income from council tax, local business rates, fees and charges, and trading income.

1.3. Reviewing the MTFS remains essential to ensuring the Council's medium term financial sustainability. The Council has responded to the financial challenges in a planned way through the work of the Lewisham Future Programmes Board (LFPB). The Board has overseen and directed the work required to bring the Council's budget in line with the Central Government's funding cuts.

1.4. The funding estimated to be received from Central Government and from council tax and business rate payers over the next four years is not sufficient to cover current level of spend and meet new budget pressures. Cuts to services are therefore required.

1.5. Local authorities are legally obliged to set a balanced budget each year and to ensure they have sufficient reserves to cover any unexpected events. Therefore, to legally balance the budget the Council must continue to make spending plans affordable by matching them to the estimated funding available over that time. The funding gap is a combination of the Council's best estimate of the future budget needed to cover rising cost pressures and demands for services alongside a reduced amount of income. Action is required now to enable the Council to meet the legal requirement to balance the budget both next year and in future years.

1.6. The Government currently distributes funds to Local Government based on proportionate need as expressed within its 'Settlement Funding Assessment' (SFA). The SFA represents a combination of monies receivable through Business Rates and Revenue Support Grant (RSG). The SFA has suffered continued reductions ever since being introduced in 2013/14, with the reductions in the RSG every year since. This is likely to change post 2019/20 following the Comprehesive Spending Review in 2019 and a number of other changes.

1.7. The Government's stated policy objective is to move to 75% devolved business rates from April 2020. This may require local authorities to assume additional responsibilities to match costs to the available business rates and enable the Treasury to reduce other sources of funding. For example; by phasing out Revenue Support Grant (RSG) and rolling in other specific grants, such as the Public Health Grant, from 2020.

1.8. As part of the preparation towards this move, the Chancellor of the Exchequer, in the last Autumn Budget, confirmed the Government's commitment to establishing a 100% business rate retention pilot in London from April 2018. Lewisham entered the Pool on the 1st April 2018 along with the other 32 London Boroughs and the Greater London Authority (GLA). The pilot is set up to run for one financial year with the potential to extend it for a longer period of time, subject to unanimous agreement.

1.9. The pilot pool was established with the guarantee that no authority would receive less funding than that which was guaranteed under the four year settlement announced in December 2015 to run from 2016/17 to 2019/20.

1.10. The Government has also committed to undertaking a Fair Funding review which would include a full review of the Needs Distribution system and possibly some 'normalisation' of council tax. Current funding levels are based on the needs assessments undertaken in 2013, increased annually by the Retail Price index, which are now outdated. Local authorities demographics and needs have changed over the years and a review of the system is essential to ensure funding remains fair.

1.11. The fair funding review will set new baseline funding allocations for local authorities by delivering an up-to-date assessment of their relative needs and resources, using the best available evidence. The first consultation exercise was undertaken from December 2017 to March 2018 and it is expected there will be more consultations later in the year, including additional research into the drivers of children social care costs.

1.12. The Government have also announced a green paper, expected in 2018, to address Health and Social Care which will likely impact the funding and governance of these services, in particular Adult Social Care for the Council.

1.13. This MTFS forecasts a further reduction in the Council's main funding from £121.1m to £110.5m between 2019/20 and 22/23. This is based on the confirmed reduction from 2017/18 to 2019/20 of 9% and an assumption that SFA will reduce by a further 9% between 2019/20 to 2022/23.

1.14. Alongside this, the Adult Social Care precept will end in 2019/20. This precept was introduced by the Government in 2017/18 as an increase in Council tax of 6% over a three year period. In 2019/20, Lewisham proposes to increase its

Council tax by 2% for this purpose (after precepts of 3% and 1% in 2017/18 and 2018/19 respectively).

1.15. In 2018/19, the Government increased the Council Tax referendum trigger point to 2.99% (normally 1.99%). It is assumed the trigger will revert to 1.99% for 2019/20 and future years.

1.16. At the same time spending projections - including pay and prices inflation, provision for budget pressures related to an increasing population and changing demographic needs, and changing responsibilities for local government - mean additional spending of at least £50m will be required to meet those needs.

1.17. The immediate target is now to deliver £16.8m of savings to bridge the gap for 2019/20. In particular, securing an agreement with health partners on the direction of additional one off resources provided for adult social care to 2019/20. The Council estimates the total level of savings required for the four year period 2019/20 to 2022/23 is approximately £53m.

1.18. The combination of these factors contributes to a lack of clarity regarding funding levels after 2019/20, the responsibilities local government will have, and the pressures and risks faced by the sector nationally and regionally. This MTFS is therefore more uncertain then in recent years. In particular for the position beyond 2019/20.

1.19. The prudential code for local authorities was consulted on in 2017 and the revised guidance, published in January 2018, requires authorities to approve a capital strategy alongside the Treasury Strategy. The rationale being to ensure; 'decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority'. These amended strategies are appended to this MTFS report to align with considerations impacting the budget. They will then be submitted for formal adoption by Council with the 2019/20 Budget.

2. PURPOSE

2.1. The main purpose of this report is to set out the medium term financial position for the Council over the next four years and the assumptions on which it is based. It also provides an overview of the current financial situation and provides an update on the delivery of the savings programme for 2019/20 and updates on the Treasury and Capital Strategies in line with new prudential code guidance.

2.2. The MTFS covers the following areas:

- It sets out the expected resource envelope that the Council's General Fund must operate within in 2019/20, attempts to project funding in future years, and identifies the main factors that might affect this.
- It sets out service and other spending projections (e.g. Housing Revenue Account, Capital Programme, Dedicated Schools Grant, and other funding streams) and the main factors that may affect these.
- It projects the General Fund funding gap which is the difference between the resource envelope and spending projections. This includes some sensitivity

analysis for an optimistic, main and pessimistic projection for each year, depending on the assumptions made, the main case representing the most likely outcome.

- It sets out the measures the Council needs to take to address the funding gap.
- It presents the 2018/19 Treasury and Capital Strategies for endorsing.

3. RECOMMENDATIONS

3.1. The Mayor is recommended to:

3.1.1. Note and endorse the 2019/20 to 2022/23 Medium Term Financial Strategy;

3.1.2. Request that a further update is brought back as part of the cuts and budget setting process to reflect any changes arising from the Autumn Budget or Local Government Finance Settlement.

3.1.3. Agree the lifting of the Departmental Expenditure Permission (DEP) / Corporate Expenditure (CEP) process except for those services that overspent in 2017/18 and delegate to the Executive Director for Resources and Regeneration to implement this.

3.1.4. Note and endorse the revised Treasury and Capital Strategies at Appendix 3 and 4 of the report.

4. STRUCTURE OF THE REPORT

4.1. The Report is structured as follows:

1. Executive Summary
2. Purpose
3. Recommendations
4. Structure of the report

<u>Strategic Review</u>

5. Introduction
6. Local Policy Context
7. Economic Context
8. Budget Update

<u>Medium Term Financial Strategy</u>

9. Introduction
10. Resource Envelope
11. Revenue Expenditure Assumptions

STRATEGIC REVIEW

5. INTRODUCTION

5.1. The MTFS represents the start of the Council's formal budget process, which concludes with the setting of the overall Budget each year. The Budget Report for 2019/20 will be presented to Mayor and Cabinet in January 2019 and full Council in February 2019.

5.2. This report sets out the scope of the Council's financial planning which includes: the General Fund; Housing Revenue Account; the Dedicated Schools Grant, other funding streams, and the Capital Programme.

5.3. The key objectives of the 2019/20 to 2022/23 Strategy are to:

- plan the Council's finances over a four year period to take account of local improvement priorities and national priorities;
- ensure that the Council's corporate priorities continue to drive its financial strategy and resource allocation;
- assist the alignment of business and financial planning processes;

- ensure that the plan takes account of: stakeholder and partner consultation; external drivers; capital investment; budget risk assessments; and expected developments in services;
- ensure that the MTFS is linked to other internal strategies and plans; and
- ensure that the final agreed budget reflects all these considerations.

5.4. Over the last nine years, the Council has undertaken a major budget reduction programme to manage the difficult financial challenge it has been faced with. In the period 2010/11 to 2018/19 the Council has implemented savings of £165m and work is underway to identify and deliver a further £17m by 2019/20.

5.5. The financial outlook for the Council and the public sector as a whole remains extremely challenging. The Government has re-affirmed the need for significant reductions in public sector expenditure over the medium term into the 2020s.

5.6. This involves the main local government grant, the Revenue Support Grant (RSG), being phased out, 75% of business rates devolved, additional responsibilities transferred to local authorities, the rolling-in of some specific grants, changes to school funding (formula and paid direct to schools), the continuing impact of the move to Universal Credit, and further health and social care integration.

5.7. At the start of 2018/19, a London Business Rates Pool was created, with the objective of trialling a 100% Business Rates Retention Scheme. All 32 London Boroughs and the City of London and the GLA agreed to setting up the pool and were given the assurance that none would be worse off in the pool than if they had been funded as usual with the RSG. The main advantages for Lewisham being part of the pool are that the pool gets to keep 100% of any growth it generates, which is then distributed across all members of the pool. In 2018/19, (Lewisham is expected to receive approximately £6m of growth from the pool); and the system of top-ups and tariffs which redistributes revenues between local authorities will be retained.

5.8. The Government has confirmed that under the proposed 75% devolution of Business Rates from 2019/20, the RSG, Public Health grant, and Transport for London Capital grant will be rolled into the Baseline Funding Level. This means Local Authorities will no longer receive a separate RSG, but will be mainly funded from Business Rates.

5.9. Other large grant funded areas, in particular the Better Care Fund, improved Better Care Fund, and some capital grants are presumed to operate within the available funding levels and service managers will adjust their staffing and contracted work accordingly.

5.10. The focus of the MTFS is the Council's General Fund budget. Whilst it is very important, particularly at a time of financial constraint, to identify ways in which all services can be delivered more effectively across traditional organisational and financial boundaries, the nature of the current financial austerity regime is such that most of the budget reductions have to come from Council's General Fund services. Having a sound General Fund MTFS and a strategy for responding to the challenges it presents is an essential pre-requisite to ensuring effective responses from all of the services the Council directs and influences.

6. LOCAL POLICY CONTEXT

6.1. The Council's strategy and priorities drive the medium term financial planning process, with changes in resource allocation determined in accordance with policies and priorities. *Shaping our future* is Lewisham's Sustainable Community Strategy. It covers the period for 2008 to 2020 and sets out a vision for Lewisham and the priority outcomes that organisations, communities and individuals can work towards to make this vision a reality. The key priorities are set out at Appendix 1 for reference.

6.2. In taking forward the Council's Budget Strategy, in engaging our residents, service users and employees, and in deciding on the future shape, scale and quality of services, we will be driven by the Council's four core values:

- We put service to the public first.
- We respect all people and all communities.
- We invest in employees.
- We are open, honest and fair in all we do.

7. THE ECONOMIC CONTEXT

National

7.1. The Chancellor of the Exchequer made his first Spring Statement speech on 13 March this year. The main highlights of his speech are as follows:

- Forecast of 1.5% growth for 2018, revised up from 1.4%. In 2019 growth is forecast to be 1.3%, then 1.3% in 2020, 1.4% in 2021, and 1.5% in 2022. In the November budget, growth was forecast at 1.3% for 2019, 1.3% for 2020, 1.5% in 2021, and 1.6% in 2022.

- Forecast for borrowing of £45.2bn in 2017-18, revised down from £49.9bn. That is equivalent to 2.2% of GDP. Borrowing is forecast to be 1.8% of GDP in 2018-19, 1.6% in 2019-20, 1.3% in 2020-21, 1.1% in 2021-22, and 0.9% in 2022-23.

- Debt will start falling as a share of GDP next year. The forecast UK debt as a percentage of GDP is 85.5% in 2018/19, 85.1% in 2019/20, 82.1% in 2020/21, 78.3% in 2021/22, and 77.9% in 2022/23. For reference debt was below 40% of GDP before the financial crisis of 2008.

7.2. The Chancellor of the Exchequer says - the UK's debt remains too high, equal to around £65,000 per household. This makes the economy vulnerable to future shocks. It also imposes a significant burden on future generations. The cost of debt interest payments is around £50 billion each year – more than the amount spent on the police and armed forces combined. The government has a balanced approach to get debt falling while funding our vital public services, keeping taxes low, and investing in Britain's future.

7.3. The next business rates revaluation has been brought forward from 2022 to 2021. The Chancellor announced a review into how to help the least productive

businesses catch up with the most, and how to eliminate late payments to small businesses was announced. This will mean businesses can benefit from the change to three-year revaluations earlier, with the first taking place in 2024.

7.4. The Chancellor announced £500m for T-levels and £50m to help employers roll out placements for T-level students and £80m to support small businesses engaging apprenticeships.

7.5. Housing growth partnership - which provides financial support for small housebuilders - will be more than doubled to £220m. London will receive £1.67 billion to start building a further 27,000 affordable homes by the end of 2021-22

7.6. In April 2018 the National Living Wage rose to £7.83, worth £600 extra a year for a full-time worker. National Minimum Wage rates for under 25s and apprentices also rose – the largest increase in youth rates in ten years. Over 2 million people are expected to benefit from April's increases.

7.7. £1.7 billion was announced at Autumn Budget 2017 for improving transport in English cities. Half of this was given to Combined Authorities with mayors. The government is now inviting bids from cities across England for the remaining £840 million.

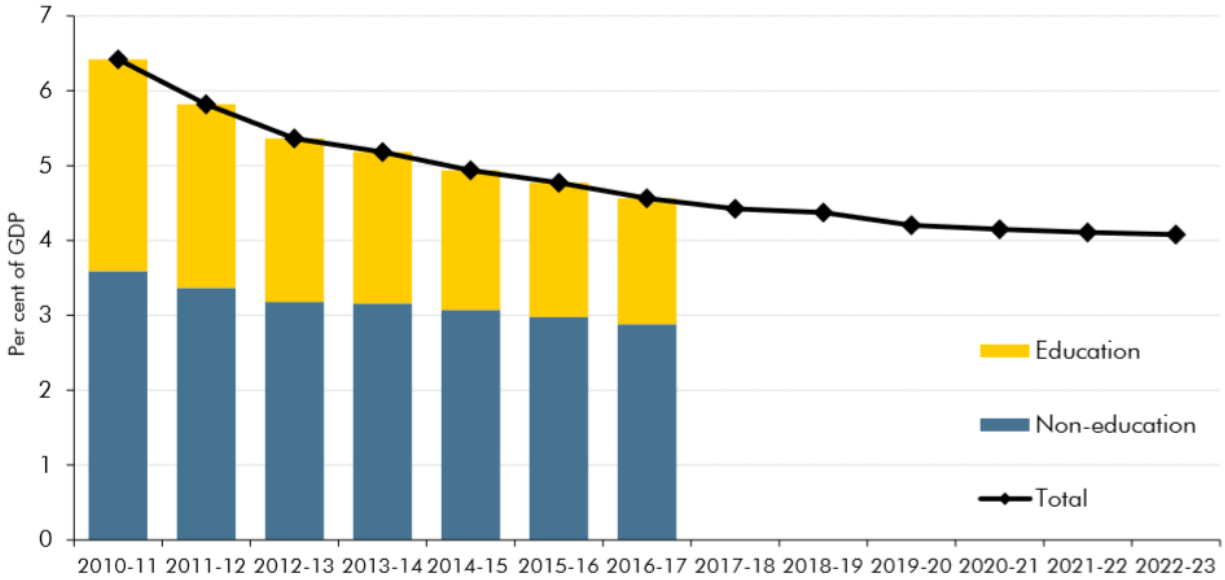
7.8. The Autumn Budget 2017 launched a £190 million Challenge Fund to help roll out full-fibre to local areas – providing the fastest, most reliable broadband to more homes and businesses. Spring Statement 2018 allocates the first wave of funding, providing over £95 million for 13 areas across the UK.

7.9. The tax-free personal allowance – the amount people earn before they start paying income tax – will rise to £11,850 from April 2018. This means that in 2018-19, a typical taxpayer will pay £1,075 less income tax than in 2010-11.

Local Government

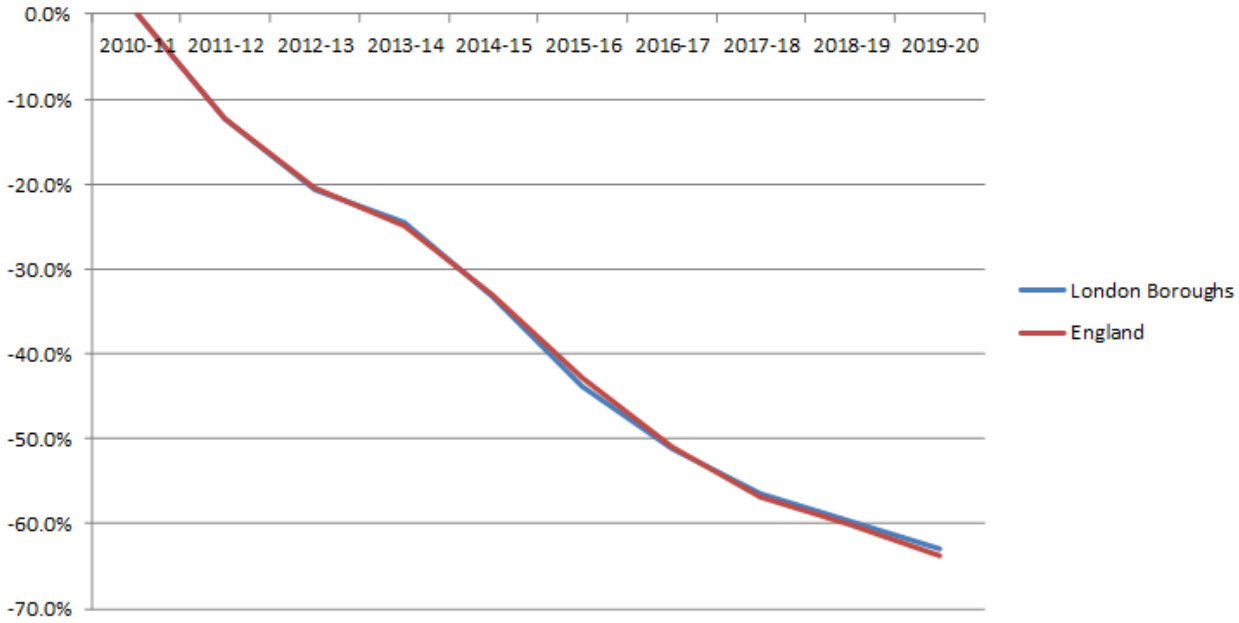
7.10. At the time of the Autumn budget HM Treasury (HMT), the Office for Budget Responsibility (OBR), and Institute for Fiscal Studies (IFS) published analysis that showed the impact of public sector austerity on local government. The graphs below show how funding has decreased year on year, how these have impacted, and where the pressures are emerging in respect of top tier authorities overspending on social care (adults and childrens).

Chart 4.8: Local authority current spending (England)

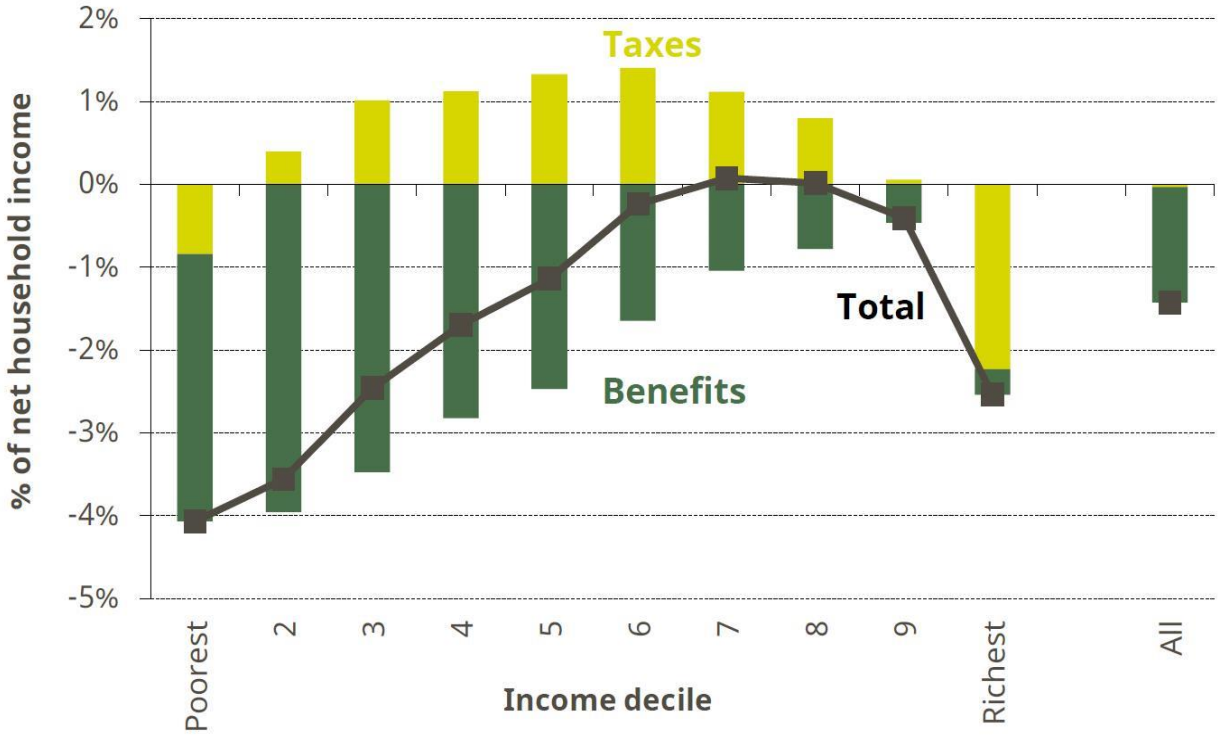


Note: Responsibility for spending on public health was transferred to local authorities from 2013-14, so numbers in previous years are not directly comparable. Figures exclude housing benefit, as the rollout of universal credit creates a discontinuity in the series.
Source: DCLG, OBR

7.11. London Councils – analysis of London Borough funding (formula grant to 2013/14 and then settlement funding - grants and business rates) reductions of 63% from 2010 to 2020.

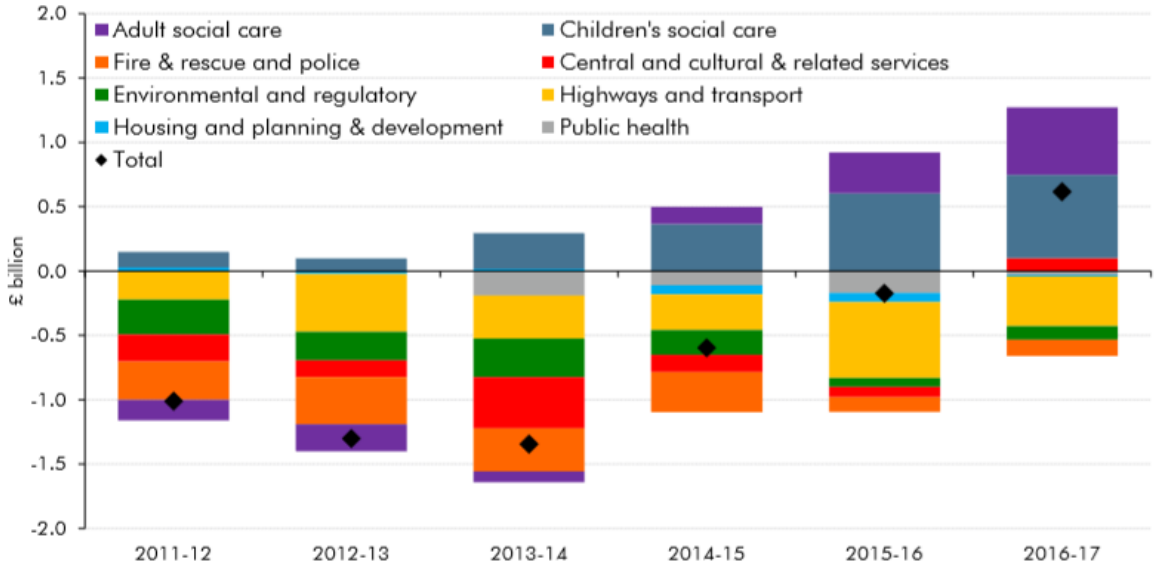


7.12. The IFS analysis at November 2017 of the impact - split of tax rises v public spending cuts and how these have impacted to each decile of the population since 2010.



7.13. The OBR analysis of the national picture reflects the experience of Lewisham with budget overspends in recent years rising due to budgets not keeping pace with the cost of Social Care.

Chart 4.9: English local authority under- and over-spends against revenue budgets by service area

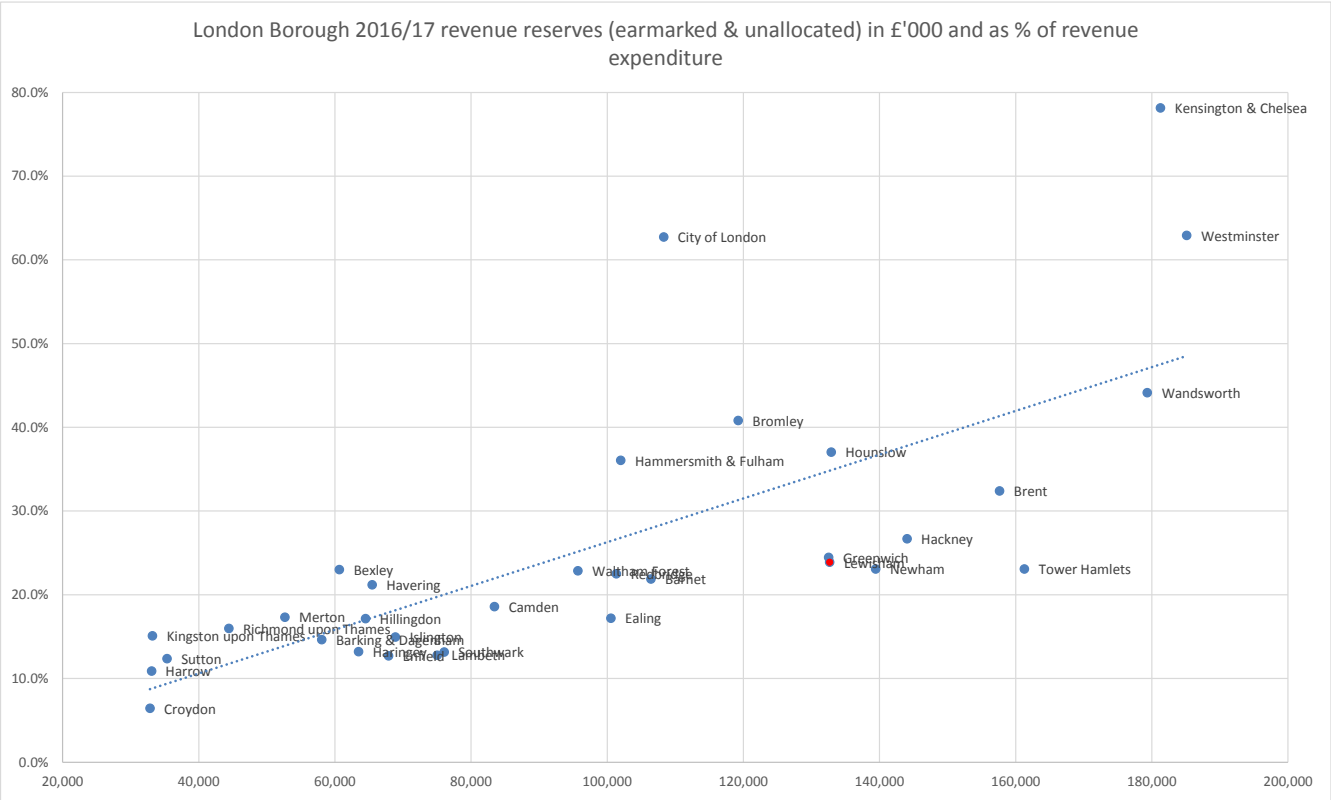


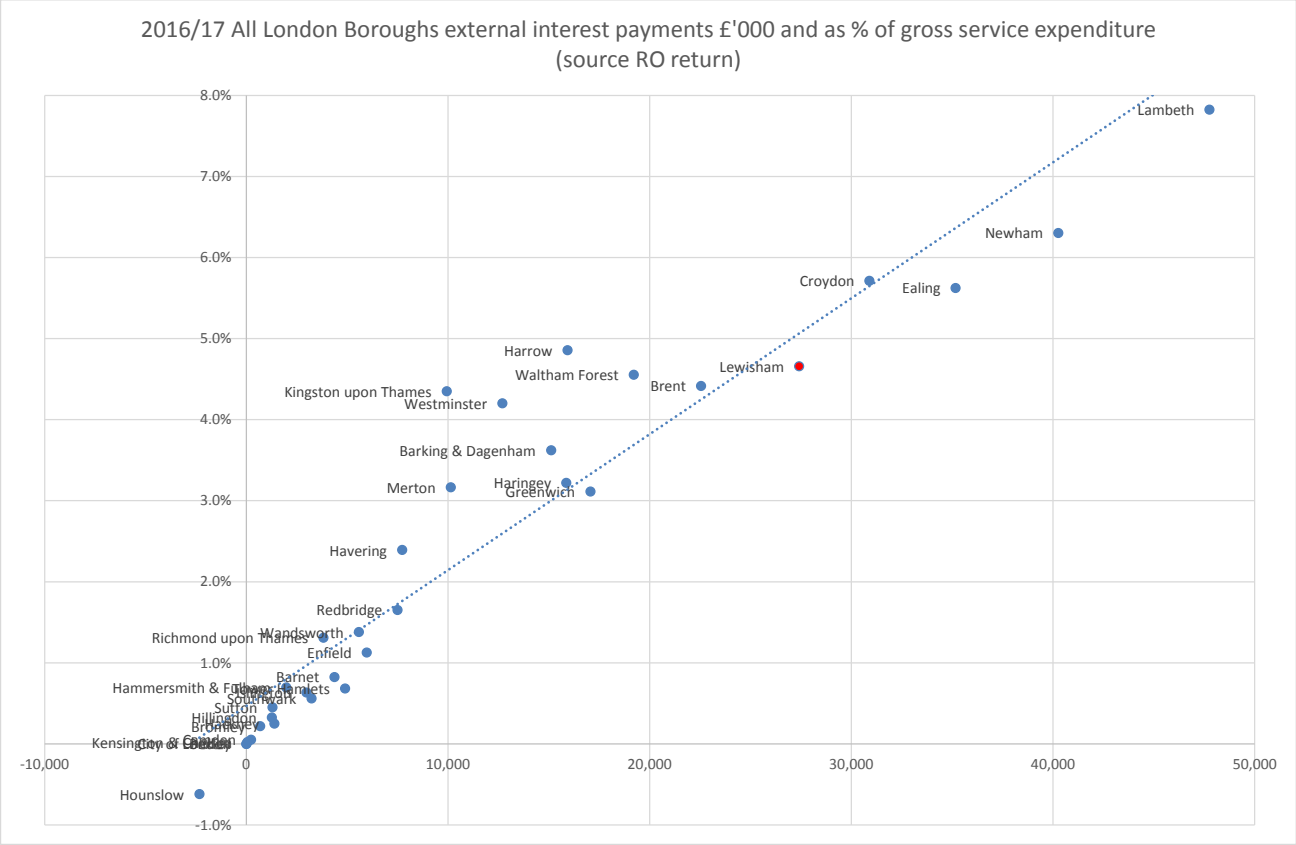
Note: Excludes spending on education and 'other' spending (which has not been allocated to one of the service areas listed). Housing services covers general fund revenue account (GFRA) spending only. Responsibility for spending on public health was transferred to local authorities from 2013-14, so numbers in previous years are not directly comparable.
Source: DCLG, OBR

London

7.14. The impact of these budget pressures and the ability of authorities to respond depends on strategies to use once-off reserves to help manage change over time and use the Treasury strategy to support investment, within the prudential code, to develop opportunities.

7.15. The two charts below show, from the 2016/17 outturn reports published by MHCLG, show the relative position of Lewisham (red dot) compared to other London Boroughs for levels of reserves and external debt financing costs in £'000 and as % of gross annual revenue expenditure.





8. BUDGET UPDATE

2017/18 Financial accounts

8.1. The Council's draft final accounts for 2017/18 have been prepared and have been submitted to the Council's external auditor, Grant Thornton. The draft accounts will be reviewed by the Audit Panel on 12 July 2018. A separate report on the Council's final outturn position for revenue and capital budgets was presented to Public Accounts Select Committee at the 9 July 2018 meeting.

8.2. The Council's final 2017/18 Directorate revenue outturn position was a Directorate overspend of £17.8m, reduced to £16.5m after applying a corporately held provision for pressures and risks of £1.3m. The Housing Revenue Account (HRA) is projecting an additional surplus of £7.9m above the already budgeted surplus of £5.1m, making the total for the year £13m. This surplus is expected to be transferred to reserves at the end of the year which will ensure that there are sufficient resources available to fund the current housing programme over the medium term. The Dedicated Schools Grant (DSG) of £289.6m was in balance at the end of the year. There were nine schools in deficit at the year-end. Of these, three of them were granted loans in excess of £0.5m. The Capital Programme spend as at 31 March 2018 was £87m. This represents 86% of the revised budget of £100.7m. The comparable figure last year was a final spend of £70.9m, which was 84% of the revised budget of £84.4m. Capital resources unspent in the year are rolled forward.

2018/19 Budget

8.3. The 2018/19 budget was approved by Council on the 21 February 2018. The overall budget position for the Council is a net General Fund Budget Requirement of £241.281m, as set out in Table1 below.

8.4. **Table 1 - Overall Budget Position for 2018/19**

Detail	Expenditure/ (Income) £m	Expenditure/ (Income) £m
Settlement Funding Assessment (SFA) for 2017/18	(128.470)	
Council Tax 2018/19 at 3.99% increase	(104.083)	
Surplus on Collection Fund	(8,728)	
Assumed Budget Requirement for 28/19		**(241.281)**
Total Resources available for 2018/19		
Base Budget for 2017/18	232.746	
Plus: Reversal of reserves drawn in 17/18 (once off)	5.027	
Plus: Additional Pay inflation	2.157	
Plus: Non-pay Inflation	2.277	
Plus: Education Support Grant changes for 18/19	0.700	
Plus: Single Persons Discount work	0.300	
Plus: Budget pressures to be funded from 18/19 fund	4.785	
Plus: Risks and other potential budget pressures	1.715	
Plus: Increase in general bad debt provision	5.000	
Less: Previously agreed savings for 2018/19	(0.580)	
Less: September approved savings for 2018/19	(4.276)	
Less: Use of New Homes Bonus reserve	(5.000)	
Less: Once-off use of reserves	(3.570)	
Total		**241.281**

2018/19 General Fund Revenue Budget Monitoring

8.5. Officers continue to undertake regular revenue budget monitoring in 2018/19. The first revenue budget monitoring is expected to report to the Public Accounts Select Committee on the 9 July 2018. The report will be based on information to the end of May 2018.

8.6. The process for monitoring is underway. It is anticipated that the main overspending areas will continue from 2017/18 and be children's social care; targeted services and joint commissioning and environmental services.

8.7. The Executive Director for Resources and Regeneration noted that, in setting the Council's budget for 2018/19, a sum of £1.7m was set aside and is being held corporately for managing 'risks and other budget pressures'. This is for items which although difficult to quantify with absolute certainty, could prove significant should they materialise. Amounts required will be confirmed by the year end.

Housing Revenue Account Monitoring

8.8. The forecast position for the Housing Revenue Account is to spend to budget for 2018/19.

Dedicated Schools Grant

8.9. The forecast position for the Dedicated Schools Grant overall is to spend to budget for 2018/19. There are however emerging pressures forecast within Special Needs (High Needs Block), which will be managed with one off funds for the short term.

8.10. The overall schools balances for 2017-18 out-turn at an £18.3m surplus (excluding external funds), but this is supported by £3m worth of loans drawn. It is however worth nothing that a substantial proportion of the surplus i.e. 90% pertains to Primary schools. Secondary schools have a cumulative surplus of £0.1m (minus external funds), with four of the eleven secondary schools in deficit.

8.11. There were nine schools in total with deficit balances totalling £1.5m at the end of the 2017-18 financial year. Of the nine schools, three are primary schools, three secondary, one each of All-through, Specialist and Nursery schools. Three of the schools in deficit have loans totalling £0.6m. There are a further six schools that are not in deficit but are benefiting from loans totalling £2.4m. These schools will need to apply for a licensed deficit. Overall school balances of £18.3 (excluding External Funds) is £5.9m higher than last year. This should be considered alongside the secondary schools observations made in paragraph 8.9 above.

Capital Programme

8.12. The proposed 2018/19 to 2020/21 Capital Programme totals £271m, with a budget of £135.8m for 2018/19.

MEDIUM TERM FINANCIAL STRATEGY (MTFS)

9. INTRODUCTION

9.1. The MTFS takes a forward view of the likely financial position of the Council over the next four years. This strategy does not seek to duplicate or replace any of the Council's other policies and strategies.

9.2. The financial strategy has produced a model with financial forecasts that aim to deliver the Council's priorities and identifies the constraints of the significant financial challenges it faces.

9.3. The MTFS projects:

a. the resource envelope the Council's General Fund must operate within in future years;

b. service and other spending pressures and the main factors that may affect these; and

c. the General Fund Funding gap which is the difference between the resource envelope and the spending projections.

9.4. As the level of uncertainty regarding funding is relatively high for years 2020/21 to 2022/23, the strategy has again modelled three indicative scenarios, the optimistic case, the **main** case, and the pessimistic case. The main case is assumed to be the most likely expected to happen. These scenarios are formulated on a number of local and national assumptions made based on the information available. These are discussed below for the main case and summarised in Appendix 2.

10. RESOURCE ENVELOPE

10.1. The resource envelope set out in this section of the report consists of the following elements:

- The 'Settlement Funding Assessment' (SFA) which is the total of Revenue Support Grant, business rate top-up, and retained business rate income; and
- Council Tax income.

Settlement Funding Assessment (SFA)

10.2. Local authorities receive funding from the government via the Settlement Funding Assessment (SFA). This consists of a combination of a share of local Business Rates and Revenue Support Grant. This financial year, Lewisham is part of the London Business Rates pool, trialling the 100% Business Rates retention for at least one year. The 2018/19 SFA is entirely paid from Business Rates.

10.3. The Government offered any Council that wished to take it up a four-year funding settlement to 2019-20 which provides funding certainty and stability. The Government confirmed the figures for 2017/18 to 2019/20 in the Local Government Finance Settlement (LGFS) in December 2017. Table 2 below sets out the announced SFA for Lewisham from 2018/19 to 2019/20 and the estimated SFA from 2020/21 to 2021/22:

Table 2: Make-up of Lewisham's Provisional and Estimated Settlement Funding Assessment, 2019/20 to 2022/23

Settlement Funding Assessment	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
Revenue Support Grant (to be rolled in to the BFL)	27.6	0	0	0
Retained Business Rates (30%)	21.0			
Business Rate Top up	72.5			
Baseline Funding Level (BFL)	93.5	116.54	113.07	110.50
Total SFA	**121.1**	**116.54**	**113.07**	**110.50**

Business rates income

10.4. Under the current local government finance system (outside the pool), the Council retains 30% of the business rate income it collects, with 37% going to the GLA and 33% paid to government. Each year the Council receives an amount (the top-up) from central government. The Council's business rate income is therefore materially impacted by the national tax take via the top-up and to a lesser degree by growth in business rates locally (see Table 2 above).

10.5. The Government has postponed the proposal to devolve 100% of Business Rates. In its place, the former Secretary of State for Housing, Communities and Local Government announced the Government's intention to increase the level of devolved Business Rates to 75%. In London, this will be shared between Local Authorities and the GLA. Assuming the 2013/14 split ratio is used (i.e. 60:40), it means LAs will retain 48% of Business Rates and the GLA 27%. The RSG will be 'rolled-in' at this stage thereby phasing it out.

10.6. Changes to Business Rates retention were intended to be fiscally neutral by allowing the main local government grant (e.g. Revenue Support Grant) to be phased out and additional responsibilities devolved to local authorities or regions, matching the additional funding from business rates.

10.7. It is not certain if existing pilots will continue for 2019/20. The local share of Business Rates could be either 75% or 100% (depending on whether the pool continues). The government is expeted to complete the next Comprehensive Spending Review in 2019 to replace the four-year funding settlement which ends in 2019/20. For this reason, any assumption beyond 2020 at this stage are officer assumptions, pending confirmation from Governement on funding allocations to authorities.

The Fair Funding Review

10.8. Central government funding for local authorities is based on an assessment of relative needs and resources. The overarching methodology that determines how much funding each authority receives annually was introduced over ten years ago and has not been updated since funding baselines were set at the start of the 50 per cent business rates retention scheme in 2013/14.

10.9. The government is therefore undertaking the Fair Funding Review to update the needs formula and set new funding baselines for the start of the new 75% business rates retention scheme, from April 2020.

10.10. Between December 2017 and March 2018 the government consulted on proposals to develop a new way of assessing need. The government is proposing to simplify the funding formula based on a small number of key cost drivers such as population, deprivation, rurality/density, and area costs. The consultation identified key areas that require a more detailed assessment of needs such as adult social care, children's services, highways and public transport, waste collection and disposal. It is anticipated that the government will consult further and move to finanalise the structure for needs and resource assessments by summer 2019 to support the CSR.

Council Tax income

10.11. In considering savings proposals and the level of Council Tax, Members make political judgements balancing these with their specific legal responsibilities to set a balanced budget and their general responsibilities to stewardship of the Council's finances over the medium term.

10.12. For 2018/19, the Government increased the percentage that Council Tax may be increased by without triggering a referendum from 1.99% to 2.99% (inclusive of levies). The Social Care Precept is in addition to this. The Social Care precept introduced by the Government from 2016/17 will continue to 2019/20. Local authorities have the flexibility to raise council tax in their area by up to 6% over the three year period 2017/18 to 2019/20, above the existing referendum threshold for council tax of 1.99% (2.99% in 2018/19). The government's assumptions for allocating resources in the provisional local government financial settlement to 2019/20 include the raising of both Council Tax and the Social Care Precept (SCP) in each and every year to meet the recognised funding pressures faced by the sector.

10.13. Council Tax income is also affected by growth in the number of properties in the borough, the rate of Council Tax collection, as well as decisions about the level of Council Tax.

10.14. In Lewisham, the 2017/18 budget made the decision for an increase in the Social Care Precept (SCP) of 3% in 2017/18 and assumed increases of 1% in 2018/19 and 2% for 2019/20.

10.15. This additional funding is ring-fenced for adult social care each year. The money continues to be committed to funding the above inflation increases in the London Living Wage for those providing adult social care.

10.16. In 2018/19, Council Tax was raised by 3.99% in total, i.e. a 2.99% core increase and the 1% social care precept increase as set out above. This generated additional funding of £4m.

10.17. The MTFS main case assumes a 3.99% increase in Council Tax for 2019/20 and thereafter a 1.99% core increase in each year. This reflects the assumption that the Council will apply 2% SCP as well as the maximum increase allowed without a referendum in 2019/20. In total over the period this will add approximately £11m to the Council Tax income base over the four year period to 2022/23.

10.18. Forecast Council Tax income from 2019/20 to 2022/23 is set out in Table 4 using the assumptions in Appendix 2. The amounts collected here are after allowing for the cost of the Council Tax Reduction Scheme and any uncollected debts.

Table 4: Council Tax Income Future Year Projections

	2019/20 projection	2020/21 projection	2021/22 projection	2022/23 projection
	£m	**£m**	**£m**	**£m**
Optimistic	112.64	119.56	126.91	134.71
Main	**110.57**	**115.88**	**120.97**	**126.16**
Pessimistic	109.34	112.66	116.08	119.60

11. REVENUE EXPENDITURE ASSUMPTIONS

11.1. In addition to the reduction in the level of resources available over the next four years, the Council faces a number of budget pressures which will add to the overall revenue expenditure. This section of the report considers the effect such pressures will have on the future years' revenue expenditure.

Pay

11.2. A pay award of 2% was agreed by the Greater London Provincial Council for 2018/19 and 2019/20. In 2019, a better than 2% increase for lower paid staff was also agreed. The main model has therefore included a 3% pay award for 2019/20 and assumed that pay awards will remain at 2% in future years.

General price inflation assumptions

11.3. General price inflation is calculated on non-pay expenditure on General Fund services (excluding internal recharges and housing benefit payments). A proportion of this expenditure is contractual with indices linked to inflation but in many cases the Council is in a position to re-negotiate increases. For the purposes of these projections, it is assumed that all prices go up by inflation, which in 2019/20 has been estimated at 2.5%.

General fees and charges assumptions

11.4. The Council's approach in the past has been to expect fees and charges it makes to rise in line with inflation unless there is a specific decision to increase them by more or less. In some cases, this will be outside the control of the Council (for example, where charge rates are set by statute). However, for the purposes of these projections of spending, it is assumed that on average fees and charges in aggregate will increase by inflation.

Further budget pressures and risks

11.5. Forecasting the impact of demand changes is the most difficult aspect of the MTFS. But the MTFS needs to make allowance for the potential impact of these. The key challenges that impact on the demand for Council services are as follows:

- **Population growth** – this particularly affects people based services such as adult and children's social care. But it also affects general demand for universal services such as leisure and cultural services and school places;
- **Ageing population** – this affects care for the very elderly but also impacts on care for younger adults and children with disabilities who are living longer as a result of improvements in medical care. It also has a direct impact on the funding the Council needs to provide for the London-wide concessionary fares scheme;
- **Household growth** – this impacts on General Fund property based services such as refuse collection and waste disposal; highways, footpaths and street lighting; and more school places and additional health and care needs.
- **Impact of government policy** – improvements in economic well-being and reduction in crime should potentially mean less demand for Council services. However, the shortage of housing, the impact of welfare changes, and policy

toward people with No Recourse to Public Funds are all having a major impact on social needs within the borough.

- **Impact of reducing preventative services** – reductions in budgets for preventative services such as early years, the youth service and aspects of adult social care provision are likely to affect demand for more acute services including children at risk, children involved in crime, adults with drug and alcohol problems, adults in residential accommodation and so on; and
- **Regulations and standards** – as the national negotiations progress to withdraw the UK from the European Union institutions, with new responsibilities for local government through anticipated funding changes, and as councils respond to recent community incidents standards and ways of working are expected to change.

11.6. The Council is pro-actively trying to address these demand pressures and seeks to ensure, wherever possible, that the changes it has to make to services reduce rather than increase demand

11.7. Other pressures, such as the cost of transition of children with disabilities into adult services or when specific grants are reduced or withdrawn, are assumed to be managed within service budgets.

11.8. Recognising these pressures and risks in flexible way as they come to bear the Council annually provides £6.5m corporately for growth from demand and other unavoidable pressures in the budget. The model assumes this will continue for future years.

Specific grant assumptions

11.9. The following assumptions have been made in the projections on specific grants which fund services. The general point is that within the Council's devolved budget management arrangements the funding position is noted and it is for the service to ensure that their spending is managed within the available grant. The main specific grants include:

- **Public Health** – this grant is £24.33m in 2018/19. The Chancellor's 2016 Autumn Statement confirmed that LAs' funding for public health would be reduced by an average of 2.6 per cent in cash terms per year until 2020, and the 2019/20 allocation is estimated at £23.68m. The Autumn Statement also confirmed that a central government grant, ring-fenced for use on public health functions, would continue for at least two more years.
- **Better Care Fund** (BCF) – this funding increased to £22.1m in 2018/19. Currently, in negotiation with the Health sector the Council receives approximately £9m of this funding to support Council led services.
- **Improved Better Care Fund** (iBCF) – the BCF was supplemented through the introduction of the iBCF from 2017/18. The difference between the BCF and iBCF is that the iBCF comes directly to Local Authorities to fund adult social care. However, as with the BCF, iBCF spending has to be jointly agreed with local Health partners. In 2018/19 the iBCF totals £6.6m, rising to £11.2m in 2019/20.

- **Adult Social Care one off funding** – in addition to the above the Government announced extra one off funding for adult social care over the three year period from 2017/18 to 2019/20. Lewisham will receive £3.9m in 2018/19 and £1.9m in 2019/20.
- **Other grants** – the Council receives a number of other grants but most are relatively small or directly related to specific projects. A number of these come from the Greater London Authority; for example, funding we receive from the London Mayor's Office for Policing and Crime (MOPAC) to support crime reduction work. As the new Mayor for London sets his priorities, any changes to these other grants will have to be met with an equivalent reduction in service spend to ensure it will have a neutral impact on the Council's overall budget gap.

Other Income and Expenditure Items

11.10. There are other income and expenditure items in the Council's budget which are mainly non-service specific. These consist of the following elements:

Capital financing charges

11.11. Capital financing costs include all revenue costs relating to the Council's outstanding borrowing which comprises repayment of principal and interest charges. It also includes provision for capital spending which is charged directly to revenue and repayment of historic debt in respect of the former Inner London Education Authority. These costs are offset by principal and interest repayments from the Catford Regeneration Partnership Limited, Lewisham Homes, and interest on the Council's investment balances.

11.12. The main factors that affect the forecasting of capital financing costs are the level of borrowing for capital purposes, the level of the Council's cash balances, and interest rates. The MTFS assumes that capital spending will be funded either from grant, capital receipts, capital reserves, be charged direct to revenue or borrowing.

11.13. Changes to interest rates should not affect borrowing costs as the Council borrows long term (typically 30 plus years) at fixed rates. It also assumes that cash balances remain at their current level. If interest rates rise the Council receives more interest on balances invested. However, the projections have not built in any assumptions about changes to interest rates as their scale is likely to be limited and the timing remains uncertain.

Levies

11.14. These cover the London Pension Fund Authority, the Environment Agency and Lee Valley. It is assumed these will stay at similar levels for future years.

Added years pension costs

11.15. In the past, staff who retired early were awarded additional assumed years in the Pension Fund with the additional cost being charged to the General Fund. Although added years stopped being awarded some years ago, the Council has an on-going commitment for those staff who were awarded added years in the past.

Other known future years' budget adjustments

11.16. There are two further adjustments that are included within the budget projections for future years, funded from the £6.5m provision stated in para 11.8 above:

- **Concessionary fares** – the cost of concessionary fares to the Council changes each year to reflect increases in population entitled to concessionary fares, increases in fares themselves, and changes to the basis for allocation of costs between boroughs. The projections assume an increase of £0.5m each year.
- **Highways and footways maintenance** – the 2014/15 budget report included a proposal to switch highways and footways maintenance funding from capital to revenue in order to avoid the build up of prudential borrowing charges. To fund this, it was agreed that £0.35m growth would be provided each year in the revenue budget together with funding that would be released within the capital financing charges budget as a result of prudential borrowing no longer being required.

New Homes Bonus

11.17. The New Homes Bonus (NHB) is a grant paid by central government to local councils for increasing the number of homes in use. Growth in the number of properties in Lewisham in line with the London Housing plan will fund the New Homes Bonus although this will be offset from 2017/18 onwards as funding for properties for which New Homes Bonus was allocated in earlier years of the system drop out of the calculation.

11.18. The grant will be paid each year for four years (previously six) for the period of this MTFS. It is based on the amount of extra Council Tax revenue raised for new-build homes, conversions, and long-term empty homes brought back into use. There is also an extra payment for providing affordable homes.

11.19. As well as the reduced period of payment, the government have introduced a baseline level of 0.4% growth such that NHB is only paid for new property numbers above this level. The impact of these changes will be to reduce the level of NHB the Council receives by at least a third and possibly a half from the current scheme level which in 2018/19, for all years in payment, is £6.9m.

11.20. The 'sharpening of the incentive' for NHB puts the onus on councils to continue to bring forward developments promptly to maintain supply of new housing in-line with local and regional plans. For Lewisham these are the targets within the London Housing Plan.

GENERAL FUND BUDGET GAP

11.21. Using the medium term resource envelope and revenue expenditure projections stated above the resulting overall forecast position for the authority is shown in Table 5 below:

Table 5: Summary of Projected Financial Position

	Optimistic Case				Main Case				Pessimistic Case			
	2019/20	**2020/21**	**2021/22**	**2022/23**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Business Rates Baseline Funding Level	121.110	118.848	117.244	116.206	**121.110**	**116.535**	**113.072**	**110.500**	**121.110**	**114.690**	**109.995**	**106.593**
RSG	0	0	0	0	**0**	**0**	**0**	**0**	0	0	0	0
NNDR S31 Grant	7.000	5.300	1.000	1.000	**7.000**	**5.300**	**1.000**	**1.000**	7.000	5.300	1.000	1.000
Ctax	112.64	119.56	126.91	134.71	**110.57**	**115.88**	**120.97**	**126.16**	109.34	112.66	116.08	119.60
Ctax Collection Fund	1.900	2.200	2.000	1.800	**1.900**	**1.800**	**1.400**	**0.800**	1.900	1.200	1.000	0.900
Total Resources	242.654	245.913	247.155	253.714	**240.576**	**239.513**	**236.440**	**238.456**	239.353	233.851	228.073	228.093
Total Revenue Expenditure	257.498	254.013	257.391	258.932	**257.498**	**251.935**	**250.991**	**248.217**	257.998	252.279	246.921	241.469
Budget Gap	14.845	8.099	10.236	5.219	**16.822**	**12.421**	**14.551**	**9.761**	19.145	18.428	18.847	13.376
Approved Savings	0.1	0	0	0	**-0.100**	**0.000**	**0.000**	**0.000**	-0.100	0.000	0.000	0.000
Additional Annual Savings Required	14.745	8.099	10.236	5.219	**16.822**	**12.421**	**14.551**	**9.761**	19.045	18.428	18.847	13.376
Cumulative Savings Required	14.745	22.844	33.080	38.299	**16.822**	**29.243**	**43.795**	**53.555**	18.545	36.973	55.820	69.195

11.22. Taking the main case scenario as the expected position, the MTFS shows the annual measures required to bridge the budget gap from 2019/20 to 2022/23 as £16.8m, £12.4m, £14.6m, £9.8m, respectively in each year. A total of £53m over the four years to 2022/23. This is a substantial budget gap for the Council, especially as savings agreed to date have totalled £165m and the financial monitoring in 2017/18 identified difficulty and delay in implementing agreed savings as a contributory cause to the reported overspend position.

11.23. The optimistic case scenario has been modelled to show the effect that positive changes in the assumptions will have on the overall budget gap. Here the culmulative budget gap to 2022/23 reduces by approximately £15m to £38m. This is based on lower predicted cuts to baseline funding and higher increase in the Council Tax base and Council Tax collection levels.

11.24. The pessimistic case scenario is the most unlikely scenario projected. The culmulative budget gap to 2022/23 increases by approximately £16m to £69m. This scenario demonstrates the difficulty the Council could potentially face if the very worst happens and the funding cuts are higher and Council Tax base and collection rates are lower than expected.

11.25. The next section of this report looks at how the Council continues to address the gap in order to produce a balance budget.

12. ADDRESSING THE BUDGET GAP

12.1. Following the start of the new administration, election of the new Mayor and joining of the new Chief Executive in May 2018, the Lewisham Future Programme as the approach to identifying, scrutinising, deciding and implementing cuts will be reviewed.

12.2. In the meantime officers, are reviewing and challenging in-year on the existing pressures carried over from 2017/18. These are identified and discussed more fully in the financial outturn and financial monitoring reported to Mayor & Cabinet separately.

12.3. For the future budget gap officers have started work on identifying possible cuts proposals to meet the immediate two year budget gap forecast in this MTFS - £17m for 2019/20 and £13m for 2020/21. The reason for planning two years ahead, recognises that some savings may first require some investment to support change and may therefore take longer, in terms of lead time, before spending is reduced.

12.4. The intial review of these is schedule for Star Chamber reviews by the Executive Management Team in July 2017. Detailed proposals for those cuts identified to be progressed will then be completed over the summer for scrutiny by Members in the Autumn. All services are part of this process.

12.5. In addition, officers with the support of Cabinet are running training for all members on the Council's financial arrangements, budget pressures, and cuts gap in July 2018. The intention being to ensure: 1) that a full set of propsoals to meet the budget gap are presented to members; and 2) that members are equipped and confident to scrutinise cuts proposals ahead of them being put to Mayor & Cabinet for decision.

Table 8: Budget Timetable – Key Dates

Month	Key Stage
October / November 2018	Scrutiny of Revenue Budget Savings / Autumn Budget statement
December 2018	Provisional Local Government Finance Settlement
	Savings report to M&C
January 2019	Final Local Government Finance Settlement
	PASC - the 2019/20 Budget Report
	Council Tax Base agreed by M&C and then Council
	National Non Domestic Rates consultation session
February 2019	Greater London Authority sets their Precept for 2019/20
	Notification of Precepts and Levies
	Mayor & Cabinet agrees the Budget & Council Tax 2019/20
	Council approves Budget & Council Tax for 2019/20

13. HOUSING REVENUE ACCOUNT

13.1. The Housing Revenue Account (HRA) is a statutory account which sets the Landlord costs and income for the housing stock.

13.2. The HRA now operates with a 30 year business plan which allows the housing strategy to be updated and implements long term planning on resources and asset maintenance. The plan contains a long-term assessment of the need for investment in assets, such as Decent Homes and other cyclical maintenance requirements, as well as forecasts on income streams such as rents, in line with rent restructuring, and future developments.

13.3. The plan also recognises certain risks. For example; the impact of government policy changes in respect of types of tenancy, rent levels, right to buy, and treatment of voids. Recently the main challenge for the HRA has been to bring forward development of new homes given the pressure on available social housing stock. There may now also be costs for the refurbishment of buildings depending on the lessons learnt from the Grenfell tower fire in June 2017.

14. DEDICATED SCHOOLS GRANT

14.1. The Dedicated Schools Grants 2018/19 for Lewisham was set by the Department for Education (DfE) at £292.3m (£265m after Academy Recoupment), although this will change during the year to reflect updated pupil numbers.

Redundancy and cost pressures

14.2. Under the current Lewisham Schools Scheme of Delegation redundancy costs are met by the school. There has been a judicial review of this instigated.

Ministers are also reviewing the position. It is uncertain whether in the future any costs will fall on Local Authorities or any decision will be retrospective.

14.3. Presently, there is a potential liability around redundancy costs of circa £818k (based on 2017/18 figures). The liability could be significantly higher if it is backdated to include previous years. These costs arise from schools implementing management action to reduce staffing in order to balance their budgets.

14.4. Across London authorities are reporting pressure on their DSG high needs block spending which, if not managed, adds to DSG pressures or, worse, becomes a further pressure for the General Fund for services that it is not intended to meet. The Lewisham high needs block has experienced rising costs in 2017/18 and is forecasting a small overspend in 2018/19 to be managed. Beyond 2019 the pressures continue to rise steeply under current modelling.

School Deficit Loan System

14.5. Lewisham operates a system to provide schools with a loan to cover budget deficits. However, should a school become a sponsored academy then any loan for revenue (rather than capital) commitments remains with the Authority. The Council's loans to schools are therefore a risk to the General Fund.

14.6. There are nine schools with loans with a balance totalling £3m. From this number seven are Secondary schools and two are Primary. Work over the year concentrated of ensuring schools with deficits budgets had a sustainable budget recovery plan. Seven loans have been agreed and the agreements signed. Two loans are pending signature.

15. CAPITAL PROGRAMME

Capital Programme Schemes and Resources 2018/19 to 2020/21

15.1. The estimated resources available, the forecast spend and the under programming within the 2018/19 to 2020/21 Committed Capital Programme are set out in Table 9 below:

Table 9: Capital Programme Resources and Forecast Expenditure 2018/19 to 2020/21 (as at June 2018)

	2018/19 £000	2019/20 £000	2020/21 £000	Total £000
SCHEMES				
General Fund	63,204	24,501	10,128	97,833
HRA	72,620	56,318	44,646	173,584
	135,824	**80,819**	**54,774**	**271,417**
RESOURCES				
Prudential Borrowing	17,681	9,030	0	26,711
Grants & Contributions	28,709	6,938	2,593	38,240
General (capital receipt, reserves, revenue)	89,434	64,851	52,181	206,466

	2018/19 £000	2019/20 £000	2020/21 £000	Total £000
	135,824	**80,819**	**54,774**	**271,417**

15.2. The proposed 2018/19 to 2020/21 Capital Programme totals £271m and brings together all capital projects across the Council. It sets out the key priorities for the Council over the next three years and is the subject of regular review.

15.3. Over the next three years the Council faces a period of financial uncertainty as revenue funding is cut and Government grants are reduced or terminated. This places increased reliance on the Council's capacity to generate capital receipts from asset sales to fund infrastructure development or can be afforded through long term borrowing. For this reason, any new projects or programmes will need to clearly demonstrate a sound business case for investment.

16. RISK MANAGEMENT

16.1. A critical element of the Council's medium term financial planning processes is to ensure that the financial consequences of risk are adequately reflected in the Council's budgets. The Council's risk register sets out those strategic and corporate risks which could materialise, together with the key risk areas in service budgets and associated mitigating measures. These include failure to contain expenditure within agreed cash limits, not meeting the revenue budget savings target and under achievement of income, as well as more specific risks on certain budgets. The risks are set out in the regular management report.

16.2. Another element to the risk management of the Council's expenditure to budget has been the DEP and CEP process in force since 2014. This is for any spend (for recruitment or services) over £100. The process has become somewhat stale and is difficult to sustain effectively across the whole organisation. It is therefore proposed to lift the general process, defaulting to the delegations in the Constitution, and then monitor the impact very carefully. However, to keep the DEP/CEP process in place for any services that report a forecast overspend. This will help focus finance and HR support to the live risks of budget pressures.

17. TREASURY AND CAPITAL STRATEGY

17.1. The prudential code for local authorities was consulted on in 2017 and the revised guidance, published in January 2018, requires authorities to approve a capital strategy alongside the Treasury Strategy. The rationale being to ensure; 'decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority'. These amended strategies are appended to this MTFS report (Appendix 3 and 4) to align with considerations impacting the budget. They will then be submitted for formal adoption by Council with the 2019/20 Budget.

17.2. CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities are required to prepare an additional report, a Capital Strategy, which is intended to provide:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed; and
- The implications for future financial sustainability.

17.3. The aim of the appended reports are enable them to be scrutined and guide officers in terms of the overall strategy, governance procedures and risk appetite entailed for captial and treasury decisions, ahead of the formal adoption of the next Treasury stragey by Council with the budget.

SUMMMARY AND IMPLICATIONS

18. CONCLUSION

18.1. The Medium Term Financial Strategy sets out initial estimates of the scale of financial challenge the Council will face over the medium term to 2022/23. It presents the outturn for 2017/18, summarises the current financial position for 2018/19, and looks forward to 2019/20 and later years.

18.2. The next stages in the development of the financial strategy will be further refinement of the Council's longer term forecasting in light of the next Spending Round, local government finance settlement, and clarity on the government's policy agenda as it impacts local government. This, in turn, will inform the Council's development of the saving proposals required to balance the Council's budget.

18.3. The Council will have to make further difficult decisions to prepare for future shortfalls. Local authorities have largely acknowledged that deep changes are required if they are to continue to deliver positive outcomes for their citizens. What is not yet clear is how authorities can continue to make this happen in practice and what local government will be responsible for and look like in future.

19. FINANCIAL IMPLICATIONS

19.1. This report is concerned with the Council's medium term financial strategy and as such, the financial implications are contained within the body of the report.

20. LEGAL IMPLICATIONS

20.1. The purpose of this report is to develop a medium term approach in support of better service and financial planning. Members are reminded that the legal requirements are centred on annual budget production, and that indicative decisions made for future years are not binding.

20.2. The Local Government Act 2000 and subsequent regulations and guidance says that it is the responsibility of the full Council to set Lewisham's budget, including all of its components and any plan or strategy for the control of the Council's capital expenditure. Regulations provide that it is for the Executive to have overall responsibility for preparing the draft budget for submission to the full

Council to consider. Once the budget has been set, it is for the Mayor & Cabinet to make decisions in accordance with the statutory policy framework and the budgetary framework set by the Council.

20.3. Where there are proposals for a reduction to a service which the Council is either under a statutory duty to provide, or which it is providing in the exercise of its discretionary powers and there is a legitimate expectation that it will consult, then consultation with all service users will be required before any decision to implement the proposed saving is taken. The outcome of such consultation must be reported to the Mayor. Where the proposed savings will have an impact upon staff, then the Council will have to consult the staff affected and their representatives in compliance with all employment legislative requirements and the Council's own employment policies.

21. EQUALITIES IMPLICATIONS

21.1. The Council's budget is of primary importance as a means of delivering Lewisham's objectives. When the budget savings and resources allocation proposals are considered during the latter part of this year, they will be assessed in terms of their impact on service delivery and equalities implications.

22. ENVIRONMENTAL IMPLICATIONS

22.1. There are no environmental implications directly arising from the report.

23. CRIME & DISORDER IMPLICATIONS

23.1. There are no crime and disorder implications directly arising from this report.

24. BACKGROUND PAPERS

Title of Document	Date	File Location	Contact Officer
Budget Report 2018/19	21 February 2018 (Full Council)	5th Floor Laurence House, Corporate Resources	David Austin
Final Revenue and Capital Outturn 2017/18	27 June 2018 (M&C)	5th Floor Laurence House, Financial Services	Selwyn Thompson
2018/19 Budget Monitoring Report	9 July 2018 (PASC)	5th Floor Laurence House, Financial Services	Selwyn Thompson

APPENDICES

Appendix 1 – Corporate Priorities

Appendix 2 – Summary of MTFS Assumptions

Appendix 3 – Capital Strategy

Appendix 4 – Treasury Strategy

Appendix 5 – Glossary of Terms

For further information on this report please contact

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APPENDIX 1 – LEWISHAM CORPORATE PRIORITIES

The six Sustainable Community Priority outcomes, agreed with the Lewisham Strategic Partnership and the Council's 10 Corporate Priorities are set out as follows:

Sustainable Community Strategy

- **Ambitious and achieving:** where people are inspired and supported to fulfil their potential.
- **Safer:** where people feel safe and are able to live free from crime, anti-social behaviour and abuse.
- **Empowered and responsible:** where people can be actively involved in their local area and contribute to supportive communities.
- **Clean, green and liveable:** where people live in high quality housing and can care for and enjoy their environment.
- **Healthy, active and enjoyable:** where people can actively participate in maintaining and improving their health and well being.
- **Dynamic and prosperous:** where people are part of vibrant localities and town centres well-connected to London and beyond.

Corporate Priorities

- **Community Leadership and Empowerment:** developing opportunities for the active participation and engagement of people in the life of the community.
- **Young people's achievement and involvement:** raising educational attainment and improving facilities for young people through partnership working.
- **Clean, green and liveable:** improving environmental management, the cleanliness and care for roads and pavements, and promoting a sustainable environment.
- **Safety, security and a visible presence:** partnership working with the police and others to further reduce crime levels and using Council powers to combat anti-social behaviour.
- **Strengthening the local economy:** gaining resources to regenerate key localities, strengthen employment skills and promote public transport.
- **Decent Homes for all:** investment in social and affordable housing to achieve the decent homes standard, tackle homelessness and supply key worker housing.
- **Protection of children:** better safeguarding and joined up services for children at risk.
- **Caring for adults and older people:** working with health services to support older people and adults in need of care.
- **Active, healthy citizens:** leisure, sporting, learning and creative activities for everyone
- **Inspiring efficiency, effectiveness and equity:** ensuring efficiency and equity in the delivery of excellent services to meet the needs of the community.

APPENDIX 2 - SUMMARY OF ASSUMPTIONS

	Optimistic Case	Main case	Pessimistic case
RESOURCE ENVELOPE			
Revenue Support Grant	• 2019/20 as per 4 year settlement • 2020 to 2024 15% reduction assumed each year	• 2019/20 as per 4 year settlement • 2020 to 23/24 20% reduction assumed per year	• 2019/20 as per 4 year settlement • 2020 to 2024 25% reduction assumed each year
Retained business rates	• 2019/20 as per 4 year settlement • 2% real terms increase each year from 2020/21 from growth in rateable value base • £1m S31 grant from 2020/21 onwards	• 2019/20 as per 4 year settlement • 1% real terms increase each year from 2020/21 from growth in rateable value base • £1m S31 grant from 2020/21 onwards	• 2019/20 as per 4 year settlement • 0.5% real terms increase each year from 2020/21 from growth in rateable value base • £1m S31 grant from 2020/21 onwards
Council Tax income	• 2019/20 3.99% change in Council Tax level (including Social Care precept) • Next 3 years 1.99% change in Council Tax level (Social Care precept ends in 19/20) • 3% increase each year in Council Tax base from 2019/20 onwards • CT collection rate of 97% each year from 2019/20 onwards • CTRS remains the same at 25%	• 2019/2020 3.99% change in Council Tax level (including Social Care precept) • Next 3 years 1.99% change in Council Tax level (Social Care precept ends in 19/20) • Increase in base aligned with Planning's New Housing trajectory increases approx. 1.5% • CT collection rate of 97% each year from 2019/20 onwards • CTRS remains at 25%	• 2019/20 3.99% change in Council Tax level (including Social Care precept) • Next 3 years 1.99% change in Council Tax level (Social Care precept ends in 19/20) • 0.5 % increase each year in Council Tax base from 2019/20 onwards • CT collection rate of 96.5% each year from 2019/20 onwards • CTRS reduces to 20% in 19/20 and for future years

	Optimistic Case	Main case	Pessimistic case
Surpluses/deficits on Collection Fund	• £1.9m estimated surplus in 2019/20, £2.2m in 2020/21, £2m in 2021/22 and £1.8m in 2022/23	• £1.9m estimated surplus in 2019/20 and £1.8m in 2020/21, £1.4m in 2021/22 and £0.8m in 2022/23	• £1.9m estimated surplus in 2019/20 and £1.2m in 2020/21, £1.0m in 2021/22 and £0.9m in 2022/23
EXPENDITURE			
Pay awards	• 3% in 2019/20 (allowing for the additional uplift of lower grades) and 2% each year afterwards	• 3% in 2019/20 (allowing for the additional uplift of lower grades) and 2% each year afterwards	• 3% in 2019/20 (allowing for the additional uplift of lower grades) and 2.5% each year afterwards
General price inflation (incl. fees and charges)	• 2.5% increase each year in non-pay budgets	• 2.5% increase each year in non-pay budgets	• 2.5% increase each year in non-pay budgets
Pressures and risks	• £6.5m growth each year	• £6.5m growth each year	• £7.5m growth each year
New legislation	• Nothing allowed	• Nothing allowed	• Nothing allowed
2018/19 budget pressures and risks	• All used and allocated to service spend	• All used and allocated to service spend	• All used and allocated to service spend
NB the MTFS assumes that any overspending is addressed in-year or met from reserves			

APPENDIX 3 – TREASURY MANAGEMENT STRATEGY

1 Background

1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the Treasury Management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the Treasury Management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

2 Treasury Management Strategy for 2018/19

2.1 The Strategy for 2018/19 covers three main areas:

i/ Capital Issues:
- Capital Investment Plans
- Prudential Indicators
- Minimum Revenue Provision (MRP) Policy

ii/ Treasury Management Issues:
- Borrowing Strategy & Treasury Indicators
- Debt Rescheduling
- Annual Investment Strategy
- Credit Worthiness Policy
- Prospects for Investment Returns

iii/ Non-Treasury Investments

2.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Community and Local Government's (MHCLG) guidance on Minimum Revenue Provision (MRP) and Investments, and the CIPFA Treasury Management Code.

3 Capital Investment Plans

3.1 The Treasury Management Strategy for 2018/19 incorporates the capital plans of the Council, as set out in section 5 of the 2018/19 Budget Report, which are a key driver of Treasury Management activity.

3.2 The Council's cash position is organised in accordance with the relevant professional codes to ensure that sufficient funds are available to meet its obligations. This involves both the organisation of the cash flow and, where capital plans require, the arrangement of appropriate borrowing facilities.

Capital Strategy

3.3 In December 2017 CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities are required to prepare an additional report, a Capital Strategy, which is intended to provide:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed;
- The implications for future financial sustainability

3.4 The aim of this report is to ensure that all elected members on full Council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

3.5 The first version of the report has been appended to the 2018/19 Medium Term Financial Strategy for Member scrutiny before an updated version is taken to full Council for approval with the 2019/20 Budget Report.

4 Prudential Indicators

4.1 The Council's final Treasury portfolio position as at 31 March 2018 with forward projections is summarised below. Table D1 compares the actual external debt from Treasury Management operations against the Capital Financing Requirement (CFR) which is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness, and so its underlying borrowing need.

4.2 The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

4.3 The CFR includes any other long-term liabilities (e.g. PFI liabilities). Whilst these increase the CFR and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI or PPP provider and so the Council is not required to separately borrow for these schemes.

4.4 The table below table illustrates over/(under) borrowing relative to the CFR.

Table D1: External Debt Projections

	2016/17 Actual £m	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
External Debt at 1 April	191.3	190.9	219.4	227.2	227.0
Change in External Debt	(0.4)	28.5	7.8	(0.2)	(4.0)
Other Long-Term Liabilities	243.8	236.1	228.3	220.7	211.9
Gross Debt at 31 March	**434.7**	**455.5**	**455.5**	**447.7**	**434.9**
Capital Financing Requirement at 31 March*	**486.4**	**488.1**	**496.4**	**490.2**	**481.0**
Borrowing – over / (under)	**(51.7)**	**(32.6)**	**(40.9)**	**(42.5)**	**(46.1)**

***The Capital Financing Requirement includes the prudential borrowing figures shown in Table A2 of Section 5 - Capital Programme in the 2018/19 Budget Report.

4.5 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

4.6 The Executive Director for Resources and Regeneration reports that the Council has complied with this prudential indicator in the current year to date and does not envisage any difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

Limits to Borrowing Activity

4.7 There are two parameters of external debt, the ‘operational boundary’ and ‘authorised limit for external debt’, which the Council reports on as part of its Prudential indicators. Both are described in further detail in the following paragraphs.

<u>The Operational Boundary for External Debt</u>

4.8 This is the limit beyond which external debt is not normally expected to exceed. In most cases this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources. The Council’s operational boundary is set out in Table D2.

Table D2: Operational Boundary

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
Maximum External Debt at 31 March	219.4	227.2	227.0	223.0
Other Long-Term Liabilities	236.1	228.3	220.7	211.9
Operational Boundary for Year	**455.5**	**455.5**	**447.7**	**434.9**

The Authorised Limit for External Debt

4.9 This key indicator represents a control on the maximum level of borrowing, and provides a limit beyond which external debt is prohibited. It reflects the level of external debt which, while not desired, could be afforded in the short term but is not sustainable in the longer term.

4.10 This is a statutory limit determined under Section 3(1) of the Local Government Act 2003, and needs to be set and revised by full Council. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.

4.11 The authorised limits are as set out in Table D3.

Table D3: Authorised Limits for External Debt

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
Operational Boundary for Year	**455.5**	**455.5**	**447.7**	**434.9**
Provision for Non Receipt of Expected Income	56.0	56.0	56.0	56.0
Authorised Limit for Year	**511.5**	**511.5**	**53.7**	**490.9**

4.12 In addition, the Council is also limited to a maximum Housing Revenue Account (HRA) CFR by the MHCLG through the HRA self-financing regime. Table D4 sets out this limit.

Table D4: HRA Debt Limit

	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
HRA Debt "Cap" (Statutory)	127.3	127.3	127.3	127.3
HRA Debt (CFR) at 31 March	(63.7)	(63.7)	(63.7)	(63.7)
HRA Borrowing "Headroom"	63.6	63.6	63.6	63.6

5 Minimum Revenue Provision (MRP) Policy

5.1 A proportion of the Council's capital expenditure is not immediately financed from its own resources. This results in a debt liability which must be charged to the Council Tax over a period of time. This repayment, the Minimum Revenue Provision (MRP) must be determined by the Council as being a prudent provision having regard to the CIPFA Prudential Code for Capital Finance.

5.2 The MRP is the amount the Council charges to the revenue account and does not correspond to the actual amount of debt repaid, which is determined by Treasury related issues. Historically the Council has applied a consistent MRP policy which comprises prudential borrowing being repaid over the useful life of the asset concerned and previous borrowing being repaid at the rate of 4% (equivalent to 25 years) of the outstanding balance.

5.3 In 2016/17 this policy was changed to reflect the useful lives of the specific asset classes on the Council's balance sheet. It moved to:

- A straight line MRP of 14% equivalent to seven years for plant and equipment (such as IT and vehicles).
- A straight line MRP of 2.5% equivalent to forty years for property (such as land and buildings).

5.4 In 2017/18 a third element was added to the Council's MRP policy, whereby no MRP need be charged on capital expenditure where the Council has assessed that sufficient collateral is held at a current valuation to meet the outstanding CFR liability, and that should it be determined at any point that insufficient collateral is held to match the Council's CFR liability a prudent MRP charge will commence.

5.5 In 2017/18 the Council took out a total of £12m in loans with the Public Works Loan Board (PWLB) and advanced it to its Arm's Length Management Organisation (ALMO), Lewisham Homes, to finance their acquisition programme to address temporary accommodation pressures. The loan agreement allows for a maximum of £20m to be drawn down by Lewisham Homes, and the final £8m was drawn down in April 2018, financed by an additional £8m loan from the PWLB.

5.6 The Authority's Capital Financing Requirement (CFR) has increased by the amount of loan advanced. Under the terms of the contractual loan agreements these funds have been advanced on an interest only basis with the principal to be returned in full at the term of the loan and interest paid throughout the life of the loan in line with the terms on which the Council has borrowed the funds. Once funds are returned to the Authority they will be classed as a capital receipt, and will be off-set against the CFR which will reduce accordingly. As the funds will be returned in full and collateral as security to the loans advanced has been agreed, there is no need to set aside a prudent provision to repay the debt liability in the interim period, so there is no MRP application.

5.7 The risk is that at some point during the term of the loan the collateral held as security is not sufficient to meet the obligations recorded by the Council. Officers will monitor the ongoing acquisition programme to ensure the security held against the loan meets the MRP exemption criteria over the life of the loan. The outstanding loan/CFR position will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence as a charge to the Council's revenue.

6 Borrowing Strategy

6.1 The Council's external debt as at 31 March 2018, gross borrowing plus long term liabilities, was £455.5m. The Council's borrowing strategy is consistent with last year's strategy. The Council is currently maintaining an under-borrowed position in that the CFR is not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow has been used as an alternative funding measure. In the current economic climate, this strategy is considered prudent while investment returns are low and counterparty risk remains an issue to be considered.

6.2 The Executive Director for Resources and Regeneration will continue to monitor interest rates in the financial markets and adopt a pragmatic and cautious approach to changing circumstances. For instance, 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 a relapse into recession or risks of deflation in the economy), then long term borrowings will be postponed and potential rescheduling from fixed rate funding into short-term borrowing considered. Any such decisions would be reported to Mayor & Cabinet and subsequently Council, at the next available opportunity.

6.3 Alternatively, 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 start date and 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 forecast. Once again, any such decisions would be reported to Mayor & Cabinet and subsequently Council, at the next available opportunity.

Policy on Borrowing in Advance of Need

6.4 Members should note that the Council's policy is not to borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within the approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

7 Treasury Indicators

7.1 There are three debt related Treasury activity limits. The purpose of these

are to restrain the activity of the Treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. These limits need to be balanced against the requirement for the Treasury function to retain some flexibility to enable it to respond quickly to opportunities to reduce costs and improve performance.

7.2 The debt related indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

7.3 The Treasury indicators and limits are set out in the following table:

Table D5: Treasury Indicators and Limits

Limits on Interest rate exposures	**2018/19**	**2019/20**	**2020/21**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates:			
• **Debt only**	100%	100%	100%
• **Investments only:**			
When total portfolio >£400m	85%	85%	85%
When total portfolio <£400m	80%	80%	80%
Limits on variable interest rates			
• **Debt only**	15%	15%	15%
• **Investments only**	75%	75%	75%
Limits on Maturity structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	10%
5 years to 10 years		0%	25%
10 years to 20 years		0%	20%
20 years to 30 years		0%	25%
30 years to 40 years		0%	50%
40 years to 50 years		0%	60%
Limits on Maturity structure of variable interest rate borrowing 2018/19			

	Lower	Upper
30 years to 40 years	0%	60%
40 years to 50 years	0%	40%

The maturity structure guidance for Lender Option Borrower Option (LOBO) loans defines the maturity date as being the next call date.

Long Term Investments Indicator

7.4 This indicator sets a limit on the total principal funds invested for greater than 365 days. This limit is set with regard to the Council's liquidity requirements and to manage the risks associated with the possibility of loss which may arise as a result of having to seek early repayment, or redemption of, principal sums invested.

7.5 The indicator and limit is set out in the following table:

Table D6: Treasury Indicators and Limits

Maximum Principal Sums Invested > 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 365 days	50.0	50.0	50.0

8 Debt Rescheduling

8.1 As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in light of the current Treasury position and the size of the cost of debt repayment (premium incurred).

8.2 In 2017/18 the Council undertook a debt restructuring exercise against one of its LOBO loans (Lender Option Borrower Option) which, after seeking the relevant advice and approvals, saw the drafting of a detailed restructuring solution which will deliver almost £24m of revenue savings to the Council over the remaining life of the loan, representing a present value benefit of approximately £5.4m.

8.3 The Council will continue to explore other rescheduling opportunities as appropriate in respect of the financing of its PFIs and external loans.

8.4 The Council has £131m of LOBO loans as of 31 March 2018 of which £10m mature and £30m will be in their call period in 2018/19. In the event that the lender exercises the option to change the rate or terms of the loans within their call period, the Council will consider the terms being provided and also the option of repayment of the loan without penalty.

8.5 The Council continuously reviews its debt position to optimise its cash flow. Any consideration of debt rescheduling will be reported to Mayor & Cabinet and subsequently to Council at the earliest meeting possible.

9 Investment Strategy

9.1 The Council's investment policy has regard to MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

9.2 The Council uses Link Asset Services as its external Treasury Management advisor. The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of Treasury Management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

9.3 In accordance with the guidance from MHCLG and CIPFA, and considering the advice of it its advisors, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

9.4 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings, as well as information on outlooks and watches. This is fully integrated into the credit methodology provided by the advisors in producing its colour codings which show the varying degrees of suggested institution creditworthiness. This has been set out in more detail at Appendix Z2.

9.5 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

9.6 Investments will be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). In order to maintain sufficient liquidity, the

Council will seek to utilise its notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest. The remainder of its investments will be placed in fixed term deposits of up to 24 months to generate maximum return.

9.7 Investment returns are likely to remain low during 2018/19 but will be on a gently rising trend over the next few years. In light of these predictions for low returns the Council continues to assess, with support from its advisors, the potential risk and return offered by investing for longer (five or more years) in pooled asset funds. This policy is set with regard to the Council's liquidity requirements and to reduce the risk of a forced sub-optimal early sale of an investment; any investments entered into will be on the advice of the Council's advisors and will continue to meet the objectives of security, liquidity and return.

9.8 Investment instruments identified for use in the financial year are listed in Appendix Z2, under the 'specified' and 'non-specified' investments categories, together with the proposed counterparty limits for 2018/19.

10 Credit Worthiness Policy

10.1 The Council's Treasury team applies the creditworthiness service provided by its advisors Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

10.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 2 years*
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days

- No colour Not to be used

*for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt

The Council's creditworthiness policy has been set out at Appendix Z2.

Country limits

10.3 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix Z3. This list will be added to, or deducted from, by officers should country ratings change in accordance with this policy.

Money Market Fund Reform

10.4 New Money Market Fund (MMF) regulations come into force on 21 July 2018 for existing funds, which give investors the option of investing in two types of funds, either Short-term MMF or Standard MMF. In addition, three structural options will be available: Public Debt Constant Net Asset Value (CNAV), Low Volatility NAV (LVNAV) and Variable NAV (VNAV).

10.5 These regulatory changes introduce enhanced safety, higher liquidity requirements, greater and more formalised transparency to investors and regulators, and a requirement for more formalised stress testing of the funds by managers. In practice, investors should notice few differences to current investment procedures.

10.6 The Council currently invests in Short-term MMF only, and Government and Prime CNAV fund structures. Under the new regulations Government CNAV funds will be classified as Public Debt CNAV funds, and Prime CNAV funds will be classified as Low Volatility NAV (LVNAV) funds.

10.7 The credit worthiness policy and credit criteria outlined in Appendix Z2 reflect the updated MMF classifications and limits. Updated fund prospectuses and agreements are likely to be issued by managers further into 2018 ahead of the implementation deadline in 2019; Council officers will consider any changes to fund structures and make changes to the Strategy if and as appropriate.

11 Prospects for Investment Returns

11.1 The Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.00% until June 2020. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.00%

- 2020/21 1.50%

11.2 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%
- 2021/22 1.50%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.75%

11.3 The overall balance of risks to these forecasts is currently probably about even and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and the outcome of Brexit negotiations.

11.4 A more extensive table of interest rate forecasts for 2018/19, including Public Works Loan Board (PWLB) borrowing rate forecasts is set out in Appendix Z1.

12 Non-Treasury Investments

12.1 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 joint ventures, and investment property portfolios.

12.2 Where such non-treasury investments exist, they will be identified and listed within this strategy. The Council's risk appetite for these investments is generally reviewed on a case-by-case basis depending on the scale and nature, and strategic fit, of the proposed investment.

13 Subsidiary Companies

13.1 The Council has two wholly owned subsidiary companies, Lewisham Homes Limited and Catford Regeneration Partnership Limited (CRPL). It has invested in these subsidiaries as outlined below.

Lewisham Homes Limited

13.2 Lewisham Homes is an arms-length management organisation (ALMO) set up in 2007 as part of the Council's initiative to deliver better housing services and achieve the Decent Homes Standard. The company manages

approximately 18,000 homes.

13.3 The Council has to date advanced two separate loans to Lewisham Homes, the first on proxy commercial terms financed from internal borrowing and the second on cost-neutral terms financed through the PWLB. Both loans are to allow Lewisham Homes to purchase properties to address temporary accommodation needs in the borough, and will be repaid on set maturity dates.

Loan Description	Method of Loan Financing	Loan Balance at 31 March 2018 £m	Interest Rate	Loan Period
£20m commercial loan, available in two tranches of £10m as and when properties are purchased	Internal Borrowing	£14.0	4.3%	10 years from drawdown date
£20m cost-neutral loan, available in blocks of at least £2m when required	PWLB	£12.0	£10.0 at 2.41% £2.0 at 2.61%	40 years from drawdown date

13.4 Agreement of the property acquisiton programme and relevant loan agreements was obtained from Mayor and Cabinet. State Aid issues and other risks and mitigations were considered in the approval of the loan facilities, including for the second loan the requirement for collateral against the loan in order to obtain MRP exemption.

Catford Regeneration Partnership Limited (CRPL)

13.5 The CRPL is a property investment company created in January 2010 which owns the Catford Shopping Centre and several neighbouring properties used to generate income whilst driving forward a regeneration programme for the town centre and surrounding area.

13.6 Three loans totalling £13.5m have been advanced to CRPL since 2010/11 to allow the company to invest in property, although these were

consolidated into one loan in February 2017. The repayment schedule allows for interest and principal repayments on a quaterly basis.

Loan Description	Method of Loan Financing	Loan Balance at 31 March 2018 £m	Interest Rate	Loan Period
£12.0m advanced in 2010/11; £0.25m advanced in 2015/16; £1m advanced in 2016/17	Internal Borrowing	£12.3	4.3%	40 years remaining (to May 2048)

13.7 The state aid compliant loans were advanced as part of the company's initial establishment and to finance new acquisitions as the company grew, approved through reports presented to Mayor & Cabinet.

14 Other Non-Treasury Investments

14.1 In 2017/18 the Council provided a loan of £700,000 to Wide Horizons, an adventure learning charity providing adventure experiences and outreach services across several London boroughs including Lewisham. An equal and corresponding loan was also advanced by the London Borough of Greenwich, providing Wide Horizons with £1.4m to repay an existing social invetsment business loan ahead of time.

14.2 The loan was advanced on a term of 24 years at a fixed rate of 3.5%, with biannual principal and interest payments. Total interest chargeable over the life of the loan is approximately £340,000. The loan was financed from internal borrowing.

14.3 The appropriate approval was sought from Mayor and Cabinet to proceed with the loan, with authority to finalise the loan terms delegated to the Executive Director for Resources and Regeneration. An appropriate financial review of Wide Horizons was undertaken, highlighting possible risks from insufficient cash flows or income generation to meet loan

repayments, although mitigating circumstances were outlined accordingly.

14.4 The Council also holds minority stakes in the following:

- 10% in Lewisham Schools for the Future LEP Limited, a Local Education Partnership established under the Council's Building Schools for the Future (BSF) programme to rebuild and refurbish secondary schools within the borough.
- Less than 1% in South-East London Combined Heat and Power Ltd (SELCHP), a joint venture with the London Borough of Greenwich for the provision of waste disposal and waste to energy processes.
- A minority share in Newable Ltd (formerly Greater London Enterprise Ltd) which provides property management and consultancy services.

APPENDIX Z1: Interest Rate Forecasts 2018 - 2021

The Council has appointed Link Asset Services as its Treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link's central view.

Period	**Bank Rate**	**PWLB Borrowing Rates %** **(including certainty rate adjustment of 20 basis points)**		
	%	**5 year**	**25 year**	**50 year**
Jun 2018	0.50	1.90	2.70	2.40
Sep 2018	0.50	2.00	2.80	2.50
Dec 2018	0.75	2.00	2.90	2.60
Mar 2019	0.75	2.10	3.00	2.70
Jun 2019	0.75	2.20	3.10	2.80
Sep 2019	1.00	2.20	3.20	2.90
Dec 2019	1.00	2.30	3.30	3.00
Mar 2020	1.00	2.30	3.30	3.00
Jun 2020	1.25	2.40	3.40	3.10
Sep 2020	1.25	2.40	3.40	3.10
Dec 2020	1.50	2.50	3.50	3.20
Mar 2021	1.50	2.50	3.50	3.20

APPENDIX Z2: Credit Worthiness Policy (Linked to Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management)

Annual Investment Strategy: The key requirements of both the Code and the investment guidance are to set an annual Investment Strategy, as part of its annual Treasury Management Strategy for the following year, covering the identification and approval of following:

- The Strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

Specified investments: These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government, such as the Debt Management Account Deposit Facility (DMADF), UK Treasury bills or a gilt with less than one year to maturity.
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating (AAA) by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society).

Within these bodies, and in accordance with the Code, the Council has set additional criteria to define the time and amount of monies which will be invested in these bodies. This criteria is as described below.

Non-Specified Investments: These are any investments which do not meet the specified investment criteria. The Council does not currently invest in non-specified investments, although provision has been made in the Strategy to invest in in pooled asset funds for periods of over one year should the relevant opportunity arise, including UK or European Residential Mortgage Backed Securities (RMBS) The Council will seek guidance on the status of any fund it may consider using, and appropriate due diligence will also be undertaken before investment of this type is undertaken.

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

These factors are weighted and combined with an overlay of Credit Default Swap CDS spreads. The end product is a series of ratings (colour coded) to indicate the relative creditworthiness of counterparties. These ratings are used by the Council to determine the suggested duration for investments.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£20m	1 year
UK Government Treasury bills	UK sovereign rating	£60m	6 months
Money Market Funds - CNAV	AAA	£30m	Liquid
Money Market Funds - LVNAV	AAA	£30m	Liquid
Money Market Funds - VNAV	AAA	£30m	Liquid
Local authorities	N/A	£10m	1 year
Term deposits with banks and building societies	Yellow* Purple Blue Orange Red Green No Colour	£30m £25m £40m £25m £20m £15m 0	Up to 2 years Up to 2 years Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use

CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£40m £25m £20m £15m 0	Up to 1 year Up to 1 year Up to 6 Months Up to 100 days Not for use
Call accounts and notice accounts	Yellow* Purple Blue Orange Red Green No Colour	£30m £25m £40m £25m £20m £15m 0	Liquid
Pooled asset funds		£50m	At least 5 years

*for UK Government debt, or its equivalent, Constant Net Asset Value (CNAV) money market funds and collateralised deposits where the collateral is UK Government debt.

The monitoring of investment counterparties: The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Executive Director of Resources and Regeneration, and if required new counterparties which meet the criteria will be added to the list. Any fixed term investment held at the time of the downgrade will be left to mature as such investments cannot be broken mid-term.

Accounting treatment of investments: The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

APPENDIX Z3: Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- USA

AA

- Abu Dhabi (UAE)
- France
- U.K.

AA-

- Belgium
- Qatar

APPENDIX Z4: Requirement of the CIPFA Management Code of Practice

Treasury Management Scheme of Delegation

(i) Full Council

- budget consideration and approval;
- approval of annual Treasury Management Strategy;
- approval of/amendments to the organisation's Treasury Management policy statement.

(ii) Public Accounts Committee

- receiving and reviewing reports on Treasury Management policies, practices and activities.

The Treasury Management Role of the Section 151 Officer

The S151 (responsible) officer has responsibility for:

- recommending Treasury Management policies for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular Treasury Management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the Treasury Management function;
- ensuring the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- approval of the division of responsibilities;
- approving the organisation's Treasury Management practices;
- preparation of capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;

- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;

APPENDIX 4 - CAPITAL STRATEGY

1. Capital Expenditure

Overview of Governance processes

1.1 The Regeneration and Capital Programme Delivery Board comprises key officers involved in the planning and delivery of the capital programme. This Board has responsibility and accountability for the delivery of all regeneration and capital projects and programmes of the built environment and is also responsible for ensuring that all projects and programmes are adequately and appropriately resourced.

1.2 The key objectives of the Board are to ensure that a consistent and corporate approach is taken to the development and authorisation of all project and programme initiation documents and the associated financing and funding of projects and programmes. It meets every two months and ensures that a corporate approach is taken to the monitoring, management and delivery of all projects and programmes. It reports through to the Regeneration Board which is chaired by the Executive Director for Resources and Regeneration.

1.3 Capital programme budget and spend information is also reported to Mayor & Cabinet and the Public Accounts Select Committee on a quarterly basis as part of the Financial Forecasts reports.

1.4 The Council's Capitalisation policies are set out annually in the Council's Statement of Accounts. Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided it adds value, increases its ability to deliver future economic benefits or service potential, or can be capitalised as a component and exceeds the Council's de-minimis limit of £40,000. Expenditure financed from the government's Devolved Formula Capital Grant is also capitalised on the basis that it increases the school's service potential. Expenditure that only maintains an asset's value (i.e. repairs and maintenance) and does not increase its ability to deliver benefits or services is charged as revenue expenditure when it is incurred.

Capital Expenditure Plans

1.5 The Council's Capital Programme budget for 2018/19 to 2020/21 was approved by Full Council on 21 February 2018. The total three year budget is £271.5m, of which £135.9m is for 2018/19. This is set out in more detail in table 1 below:

Table 1

	18/19 £m	19/20 £m	20/21 £m	3 Year Total £m
General Fund				
Smarter Working Programme	2.0	0.6	0.0	**2.6**
Schools – Pupil Places and other Capital Works	18.8	1.0	0.8	**20.6**
Highways, Footways and Bridges	3.1	3.5	3.5	**10.1**
Regeneration Schemes	8.0	5.2	0.0	**13.2**
Lewisham Homes Property Acquisition	10.0	6.0	0.0	**16.0**
Town Centres and High Street Improvements	2.8	2.3	0.8	**5.9**
Asset Management Programme	3.9	2.5	2.5	**8.9**
Fleet Replacement Programme	2.6	0.0	0.0	**2.6**
Beckenham Place Park	5.5	1.7	0.6	**7.8**
Other Schemes	6.5	1.7	1.9	**10.1**
General Fund total	**63.2**	**24.5**	**10.1**	**97.8**
Housing Revenue Account	**72.7**	**56.3**	**44.7**	**173.7**
Total Programme	**135.9**	**80.8**	**54.8**	**271.5**

1.6 The resources available to finance the proposed Capital Programme are as set out in table 2 below:

Table 2

	18/19 £m	19/20 £m	20/21 £m	3 Year Total £m
General Fund				
Prudential Borrowing	17.7	9.0	0.0	**26.7**
Grants and Contributions	28.7	7.0	2.6	**38.3**
Capital Receipts	2.5	1.1	0.0	**3.6**
Reserves / Revenue	14.3	7.4	7.5	**29.2**
	63.2	**24.5**	**10.1**	**97.8**
Housing Revenue Account				
Prudential Borrowing	0.0	0.0	0.0	**0.0**
Grants	0.0	0.0	0.0	**0.0**
Specific Capital Receipts	0.0	0.0	0.0	**0.0**
Reserves / Revenue	72.7	56.3	44.7	**173.7**
	72.7	**56.3**	**44.7**	**173.7**
Total Resources	**135.9**	**80.8**	**54.8**	**271.5**

1.7 The General Fund resources available to finance capital projects decrease over the term of the Programme. This reflects the Council's prudent approach to long-term planning, with grants for later years not taken into account until they have been confirmed, and capital receipts only being taken into account when they have been received or are reasonably certain of being received. The Council prudently avoids entering into long-term expenditure commitments until there is more certainty as to how they can be financed.

Asset Management Planning

1.8 In March 2015 the Council published a new corporate Strategic Asset Management Plan 2015-2020 that set management of corporate assets within the framework of the following outcomes:

- Compliance with regulation and responsiveness to risk.
- Improving the quality of services that can be delivered through the corporate asset function.
- Reducing expenditure and exposure to costs; and
- Increasing income generated and collected.

1.9 Further detail can be found in the Council's Strategic Asset Management Plan 2015-2020:
https://www.lewisham.gov.uk/mayorandcouncil/aboutthecouncil/strategies/Documents/150330%20SAMP%20Final.docx

Restrictions concerning capital finance

1.10 Within the prudential framework there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. The Council's Prudential Indicators are approved by Full Council each year as part of the Budget Report. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for the current and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

1.11 There are two parameters of external debt, the 'operational boundary' and 'authorised limit for external debt', which the Council reports on as part of its Treasury indicators.

1.12 The Operational Boundary for External Debt is the limit beyond which external debt is not normally expected to exceed. In most cases this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

1.13 The Authorised Limit for External Debt is a key prudential indicator which represents a control on the maximum level of borrowing, and provides a limit beyond which external debt is prohibited. It reflects the level of external debt which, while not desired, could be afforded in the short term but is not sustainable in the longer term. This is a statutory limit determined under Section 3(1) of the Local Government Act 2003, and needs to be set and revised by full Council. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.

1.14 Council borrowing in relation to the Housing Revenue Account capital programme is restricted by the Housing Revenue Debt Cap which has been set by Government at £127,278,550.

2. Debt and borrowing and treasury management

2.1 The latest Treasury Management Strategy, which is within the 2018/19 Budget Report, shows the Council's projection of external debt as in Table 3:

Table 3

External Debt Projections	2016/17 Actual £m	2017/18 Expected £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
External Debt at 1 April	191.3	190.9	217.4	217.2	217.0
Change in External Debt	(0.4)	26.5	(0.2)	(0.2)	(4.0)

External Debt Projections	2016/17 Actual £m	2017/18 Expected £m	2018/19 Forecast £m	2019/20 Forecast £m	2020/21 Forecast £m
Other Long-Term Liabilities	243.8	236.2	228.3	220.7	211.9
Gross Debt at 31 March	**434.7**	**453.6**	**445.5**	**437.7**	**424.9**
Capital Financing Requirement at 31 March*	**486.4**	**487.1**	**496.4**	**490.2**	**481.0**
Borrowing – over / (under)	**(51.7)**	**(33.5)**	**(50.9)**	**(52.5)**	**(56.1)**

2.2 Where the Council is under-borrowed and has the resources to do so, internal borrowing may be used to support capital expenditure in particular circumstances. This is considered a prudent approach in the current economic climate while investment returns are low.

2.3 As at 31 March 2018 the Council's internal borrowing was estimated at £18.0m. New internal borrowing of £0.7m was initially utilised in 2017/18 to finance a loan to Wide Horizons, an adventure learning charity serving several London boroughs including Lewisham. The interest receivable on the loan was forecast to be greater than could be achieved if the funds were invested through the Council's Treasury function. Should this change over the life of the loan, the Council will make a decision on any external borrowing arrangements accordingly.

2.4 The Minimum Revenue Provision (MRP) is a provision for the repayment of debt over the life of the underlying debt. It is a prudent provision as advised by the CIPFA Prudential Code for Capital Finance.

2.5 The Council's current MRP Policy is based on the useful lives of specific asset classes:

- A straight line MRP of 14% equivalent to seven years for plant and equipment (such as IT and vehicles).
- A straight line MRP of 2.5% equivalent to forty years for property (such as land and buildings).

2.6 In 2017/18 a third element was added to the Council's MRP policy, whereby no MRP need be charged on capital expenditure where the Council has assessed that sufficient collateral is held at a current valuation to meet the outstanding CFR liability, and that should it be determined at any point that insufficient collateral is held to match the Council's CFR liability a prudent MRP charge will commence.

2.7 The Council's Authorised Limit is £501.5m and Operational Boundary is £445.5m for 2018/19 (see also paragraphs 1.12 and 1.13). The Council's Treasury Management Strategy (including processes, due diligence and

defining the authority's risk appetite) is approved annually by Full Council as part of the Council's Budget Report.

3. Commercial Activity

3.1 The consideration of commercial activity within the context of a capital strategy falls into three main areas: new projects/schemes; existing regeneration vehicles; and existing commercial property portfolios.

- As part of the Regeneration and Capital Programme Delivery Board's annual process of securing capital bids for funding new projects, the ability of projects and programmes to self-fund or part fund through commercial activity is reviewed as these schemes are progressed subject to sufficient due diligence to ensure that the risk to the Council is minimised or mitigated appropriately. This due diligence primarily takes the form of the preparation of a PID to achieve initial feasibility and seed funding, and then the production of a full Business Case before further capital funds are made available. The preparation of the full Business Case generally requires independent input from professional services firms to either prepare or review the technical assumptions and costings, as well as the economic and financial impacts and outputs. The Council's risk appetite is generally reviewed on a case by case basis depending on the scale and nature of the proposed investment and its strategic fit.

- The Council also pursues commercial activity separately through the business of its wholly owned company Catford Regeneration Partnership Limited which was established to provide a regeneration vehicle for Catford town centre. The Council transferred land holdings into the vehicle which was funded through state aid compliant lending from the Council. This vehicle now manages these properties on a commercial basis in anticipation of the wider regeneration of the area being delivered under the capital programme.

- The final area of commercial activity is through the existing commercial property estate. These are commercial properties held in the general fund and run on a commercial basis. The Council's commercial property estate comprises 312 assets with a gross rental income of approximately £3.7m. To give some perspective, this income represents approximately 1.8% of the Council's total budgeted General Fund income of £210m.

4. Other long-term liabilities

4.1 Aside from borrowing, there are a number of other significant long-term liabilities recognised on the Council's balance sheet. The bullet points below outline the nature of these liabilities, their value as at 31 March 2018 and the governance processes around their monitoring and ongoing risk management.

- Pension Liability (£640m). This liability matches a debit balance in the Pensions Reserve and reflects the timing differences which arise from the

accounting treatment for post-employment benefits and for funding benefits in accordance with statutory provisions. The Council accounts for post-employment benefits in the Comprehensive Income and Expenditure Statement as the benefits are earned by employees accruing years of service, updating the liabilities recognised to reflect inflation, changing assumptions and investment returns on any resources set aside to meet the costs. However, statutory arrangements require benefits earned to be financed as the Council makes employer's contributions to pension funds or eventually pays any pensions for which it is directly responsible. The liability therefore represents a shortfall between the benefits earned by past and current employees and the resources the Council has set aside to meet them. The statutory arrangements regarding the Pension Fund ensure that funding will have been set aside by the Council by the time the benefits are due to be paid.

- Private Finance Schemes (£228m). The Council's contribution towards the cost of PFI schemes is through unitary charge payments which are made throughout the life of the scheme concerned. The unitary charge payments have been calculated to include three elements: a service charge; the repayment of debt in relation to capital expenditure in delivering the scheme assets; and the finance cost on the borrowing to deliver to initial investment. The long-term liability represents the amount of debt outstanding in relation to capital expenditure; this will be repaid to the contractors through the unitary charge payments over the life of the PFI schemes. The Council employs robust and proactive contract management procedures to ensure that the PFI schemes continue to deliver value for money.

- Provisions (including insurance) (£5m). Provisions are amounts which are set aside where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement at a later date and where a reliable estimate can be made of the amount of the obligation. The Council's insurance programme comprises a mix of external insurance, largely for cover at catastrophe level or where required by contract or lease arrangements, and self-insurance. Dedicated insurance provisions and reserves are maintained to provide 'self-insurance' to meet either uninsured losses or losses that fall below the external insurance excess. The appropriate levels are assessed annually by the Council's insurance actuaries.

5. Knowledge & Skills

5.1 The Council uses Link Asset Services as its external Treasury Management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of Treasury Management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by

which their value will be assessed are properly agreed and documented, and subjected to regular review.

5.2 MiFID II is a piece of European legislation which recently came into force. It affects our relationship with all institutions with whom we have a financial relationship, both council and pension fund. The Council have fulfilled a set of tests to prove we are competent investors and have the requisite skills and knowledge in place. As an example, for treasury management, we have provided information on those staff involved from the Executive Director of Resources & Regeneration downwards, to include their qualifications, years in the role, and any regular training attended.

APPENDIX 5 - GLOSSARY OF TERMS

Actuarial valuation

An independent report of the financial position of the Pension Fund carried out by an actuary every three years. The actuary reviews the Pension Fund assets and liabilities as at the date of the valuation and makes recommendations such as, employer's contribution rates and deficit recovery period, to the Council.

Baseline funding level

The amount of a local authority's start-up funding allocation which is provided through the local share of the estimated business rates aggregate (England) at the outset of the scheme as forecast by the Government. It forms the baseline against which tariffs and top-ups are calculated.

Budget Requirement

The Council's revenue budget on general fund services after deducting funding streams such as fees and charges and any funding from reserves. (Excluding Council Tax, RSG and Business Rates)

Business Rates Baseline

The business rates baseline is equal to the amount of business rates generated locally in a specific year.

Capital expenditure

Spend on assets that have a lasting value, for example, land, buildings and large items of equipment such as vehicles. This can also include indirect expenditure in the form of grants or loans to other persons or bodies.

Capital Programme

The Council's plan of future spending on capital projects such as buying land, buildings, vehicles and equipment.

Capital Receipts

These are proceeds from the disposal of land or other assets and can be used to finance new capital expenditure but cannot be used to finance revenue expenditure.

Capping

This is the power under which the Government may limit the maximum level of local authority spending or increases in the level of spending year on year, which it considers excessive. It is a tool used by the Government to restrain increases in Council Tax. The Council Tax cap, currently 2%, means that any local authority in England wanting to raise Council Tax by more than 2% in 2015/16 must consult the public in a referendum, Councils losing a referendum would have to revert to a lower increase in their bills.

CIPFA

The Chartered Institute of Public Finance and Accountancy are one of the UK accountancy institutes. Uniquely, CIPFA specialise in the public sector. Consequently CIPFA holds the responsibility for setting accounting standards for local government.

Collection fund

A statutory account maintained by the Council recording the amounts collected from Council Tax and Business Rates and from which it pays the precept to the Greater London Authority.

Collection Fund surplus (or deficit)

If the Council collects more or less than it expected at the start of the financial year, the surplus or deficit is shared with the major precepting authority, in Lewisham's case this is the GLA, in proportion to the respective Council Taxes. These surpluses or deficits have to be returned to the Council taxpayer in the following year through lower or higher Council taxes. If, for example, the number of properties or the allowance for discounts, exemptions or appeals vary from those used in the Council Tax base, a surplus or deficit will arise. The Council generally achieves a surplus, which is shared with the GLA.

Contingency

This is money set-aside centrally in the Council's base budget to meet the cost of unforeseen items of expenditure, such as higher than expected inflation or new responsibilities.

Council Tax Base

The Council Tax base for a Council is used in the calculation of Council Tax and is equal to the number of Band D equivalent properties. To work this out, the Council counts the number of properties in each band and works out an equivalent number of Band D equivalent properties. The band proportions are expressed in ninths and are specified in the Local Government Finance Act 1992. They are: A 6/9, B 7/9, C 8/9, D 9/9, E 11/9, F 13/9, G 15/9 and H 18/9, so that Band A is six ninths of the 'standard' Band D, and so on.

CPI and RPI

The main inflation rate used in the UK is the CPI (Consumer Price Index), the Chancellor of the Exchequer bases the UK inflation target on the CPI. The CPI inflation target is currently set at 2%. The CPI differs from the RPI (Retail Price Index) in that CPI excludes housing costs. Also used is RPIX, which is a variation on RPI, one that removes mortgage interest payments.

Dedicated schools grant (DSG)

This is the ring-fenced specific grant that provides most of the Government's funding for schools. This is distributed to schools by the Council using a formula agreed by the schools forum.

Financial Regulations

These are a written code of procedures set by a local authority, which provide a framework for the proper financial management of the authority. They cover rules for accounting and audit procedures, and set out administrative controls over the authorisation of payments, etc.

Financial Year

The local authority financial year commences on 1st April and finishes on the following

General Fund

This is the main revenue fund of the local authority, day-to-day spending on services is met from the fund. Spending on the provision of housing however, must be charged to the separate Housing Revenue Account (HRA).

Gross Domestic Product (GDP)

GDP is defined as the value of all goods and services produced within the overall economy.

Gross expenditure

The total cost of providing the Council's services, before deducting income from Government grants, or fees and charges for services.

Housing Revenue Account (HRA)

A separate account of expenditure and income on housing that Lewisham must keep. The account is kept ring-fenced from other Council activities. The Government introduced a new funding regime for social housing within the HRA from April 2012.

Individual authority business rates baseline

This is derived by apportioning the billing authority business rates baseline between billing and major precepting authorities on the basis of major precepting authority shares.

Levies

A levy is an amount of money a local authority is compelled to collect (and include in its budget) on behalf of another organisation. Lewisham is required to pay levies to a number of bodies such as the London Pensions Fund Authority.

Local share

This is the percentage share of locally collected business rates that will be retained by local government, currently 50%.

Net Expenditure

This is gross expenditure less services income, but before deduction of government grant.

New Homes Bonus

Under this scheme Councils receive a new homes bonus (NHB) per each new property built in the borough for the first six years following completion. Payments are based on match funding the Council Tax raised on each property with an additional amount for affordable homes. It is paid in the form of an un-ringfenced grant.

Prudential Borrowing

Set of rules governing local authority borrowing for funding capital projects under a professional code of practice developed by CIPFA to ensure the Council’s capital investment plans are affordable, prudent and sustainable.

Revenue Expenditure

The day-to-day running expenses on services provided by Council.

Revenue Support Grant (RSG)

All authorities receive Revenue Support Grant from central government in addition to its baseline funding level under the local government finance system. An authority's Revenue Support Grant amount plus its baseline funding level together comprises its Settlement Funding Assessment.

Section 151 officer

Legally Councils must appoint under section 151 of the Local Government Act 1972 a named chief finance officer to give them financial advice, in Lewisham's case this is the post of the Executive Director for Resources and Regeneration.

Settlement Funding Assessment (SFA)

A local authority's share of the local government spending control total which comprises its Revenue Support Grant for the year in question and its baseline funding level.

Specific Grants

As the name suggests funding through a specific grant is provided for a specific purpose and cannot be spent on anything else e.g. The Dedicated Schools Grant (DSG) for schools.

Treasury Management

The process of managing the Council's cash flows, borrowing and cash investments to support Lewisham's finances. Details are set out in the Treasury Management Strategy which is approved by Mayor and Cabinet and Full Council in February each year.