Rushcliffe Borough Council

Governance Scrutiny Group

Thursday, 30 June 2022

Capital and Investment Strategy Outturn 2021/22

Report of the Director – Finance and Corporate Services

1 Purpose of report

1.1 The purpose of this report is to summarise the transactions undertaken during the 2021/22 financial year reporting against the Council's Capital and Investment Strategy 2021/22-2025/26.

1.2 The report also provides information on the Council's commercial investment activity as it embraces the new CIPFA Code ensuring there is both transparency and scrutiny in terms of both treasury and asset investment decision making.

2 Recommendation

2.1 It is RECOMMENDED that the Governance Scrutiny Group agrees the 2021/22 outturn position.

3 Reasons for Recommendation

3.1 This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing Treasury Management activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Finance in Local Authorities (the Prudential Code).

3.2 The Prudential Code has recently been updated following a consultation exercise. Proportionality has now been included as an objective, there has been clarification around the definition of commercial activity and investments, and the purchase of commercial property purely for profit can no longer lead to an increased capital financing requirement (CFR) ie it prohibits future PWLB borrowing. CIPFA has also introduced a liability benchmark as a treasury management indicator. It is important to note the section on commercial investments from paragraph 4.26 does cover the issue of proportionality with different types of asset investments the Council has made.

4 Supporting Information

TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2021/22, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year are as follows:

Prudential and treasury indicators	2020/21 Actual £000	2021/22 Estimate £000	2021/22 Actual £000
Capital expenditure	9,306	28,158	16,276
Capital Financing Requirement	6,300	16,909	7,726
Investments	(47,127)	(20,752)	(67,785)

4.2 The approved capital programme for 2021/22 was £28.158m, with £6.533m brought forward from 2020/21 plus further adjustments of £0.911m and agreed reprofiling of £8.380m during the year giving a total provision for the year of £27.222m. Actual expenditure against the approved programme was £16.276m (60%) giving rise to a variance of £10.946m. Carry forwards of £10.710m have been approved by Cabinet as part of the Final Outturn Report (July 2022). The increase in the Investments balance between years reflects slippage in the Capital Programme and additional S106 deposits.

Capital Expenditure and Financing

4.3 The Council undertakes capital expenditure on both its own long-term assets and on grants that can be capitalised under statute (capital payments to third parties). These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.) which has no resulting impact upon the Council's borrowing need; or
- If insufficient financing is available or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

4.4 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed:

	2020/21 Actual £000	2021/22 Estimate £000	2021/22 Actual £000
Capital Expenditure	**9,306**	**28,158**	**16,276**
Less Financed by:			
Capital Receipts	(7,600)	(15,199)	(7,787)
Capital Grants	(1,557)	(6,003)	(5,747)
Reserves	(149)	(500)	(242)
Increase in Borrowing Need	**-**	**6,456**	**2,500**

Re-profiling of expenditure on Bingham Hub and the Crematorium has reduced the need to borrow in 2021/22 and all of the expenditure can be financed from the Council's capital resources and internal borrowing (using the Council's own cash balances) mitigating the need to externally borrow.

The Council's Overall Borrowing Need

4.5 The Council's underlying need to borrow for capital expenditure is called the Capital Financing Requirement (CFR). The CFR represents the net capital expenditure in 2021/22 and prior years that has not yet been paid for by revenue or other resources.

4.6 Part of the Council's Treasury Management activity is to organise the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be through utilising temporary cash resources within the Council (internal borrowing) or sourced through borrowing from external bodies, for example, the Public Works Loan Board (PWLB).

4.7 Where a positive CFR exists, the Council is required, by statute, to make an annual charge called the Minimum Revenue Provision (MRP) to reduce the CFR based on the life of the relevant assets. This provision effectively raises cash to either help repay loans or replenish internal borrowing.

4.8 The total CFR can be reduced by:

- The application of additional resources (such as unapplied capital receipts); or
- Charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

4.9 Since 2017/18 the Council decided to set the MRP at £1m. This comprised £0.250m MRP to finance the Arena based on £10m borrowing over a 40-year life. A further £0.750m was provided by way of VRP to meet the Council's commitment to repay the borrowing early. The Council has been releasing an equivalent sum (£1m) from the New Homes Bonus (NHB) Reserve to offset any impact of the borrowing charge to the taxpayer in-year. This practice will continue although with new schemes increasing borrowing requirements, the amount of MRP will increase until the Arena is repaid in full in 2026-27 then MRP will fall and VRP will stop.

4.10 The Council's CFR for 2021/22 represents a key prudential indicator and is shown below. The table shows additional internal borrowing was needed in 2021/22 giving a closing balance of £7.726m after deducting the MRP of £1.074m in 2021/22.

Capital Financing Requirement (CFR)	**2020/21 Actual £000**	**2021/22 Actual £000**
Opening Balance	**7,300**	**6,300**
Add: unfinanced Capital Expenditure (per above)	**-**	**2,500**
Less: MRP/VRP	(1,000)	(1,074)
Closing Balance	**6,300**	**7,726**

Net Borrowing, CFR, Authorised Limit and Operational Boundary

4.11 The borrowing activity is normally constrained by prudential indicators for net borrowing, the CFR and by the Authorised Limit for external debt.

4.12 The authorised limit is the “affordable borrowing limit” required by section 3 (1) of the Local Government Act 2003 and represents the limit beyond which borrowing is prohibited and was set at £25m.

4.13 As the Council had no recourse to borrow externally during 2021/22 these indicators were not breached.

4.14 Similarly, the Council is required to set an operational boundary, which is the expected borrowing position of the Council during the course of the year. The operational boundary is not a limit and actual borrowing can be either below or over the boundary subject to the authorised limit not being breached. The Operational Boundary was set at £20m in case any borrowing is required in emergency circumstances. The Authorised limit of £25m gives room for any variations from this. Any borrowing in excess of this would require Full Council approval.

The Ratio of Financing Costs to Net Revenue Streams

4.15 This is an indicator of affordability and compares net financing costs (MRP, borrowing costs, including interest foregone from the use of cash balances less investment income) to net revenue income. This indicator shows how the proportion of net income used to pay for financing costs. The actual is lower than originally estimated primarily as a result of income from investments exceeding expectations and larger investment balances due to additional S106 monies and Community Infrastructure Levy (CIL).

	2020/21 Actual	2021/22 Estimate	2021/22 Actual
General Fund	2.81%	5.45%	3.43%

Upper Limits for Fixed and Variable Rate Exposure

4.16 The purpose of these indicators is to allow the Council to manage the extent to which it is exposed to changes in interest rates. We have been holding unusually large cash balances so not looking to borrow hence interest from fixed rate investments have been relatively low.

	2021/22 Limit	2021/22 Actual
Fixed Upper Limit for Fixed Interest Rate Exposure	50%	8%
Variable Upper limit for Variable Interest Rate Exposure	100%	92%

Upper Limit for Total Principal Sums invested over 1 year

4.17 This limit is intended to contain the exposure to the possibility of any loss that may arise as a result of the Council having to seek early repayment of any investments made. If an investment had to be repaid before its natural maturity date due to cash flow requirements, then, if market conditions were unfavourable, there would be an adverse impact on the Council.

	2021/22 Limit £000	2021/22 Actual £000
Upper Limit for Total Principal Sums Invested over 364 days	10,400	0

Treasury Position on 31 March 2022

4.18 The Council's debt and investment position is managed by the Treasury team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all Treasury Management activities in line with the approved treasury strategy. Procedures and controls to achieve these objectives are established through reports to Members via the Governance Scrutiny Group and reporting and through officer activity detailed in the Council's Treasury Management Practices. The following table details the Counterparties that the Council had placed investments with at the end of 2021/22.

Financial Institution	£	Duration	Interest
Goldman Sachs Asset Management	5,000,000	182 days	0.12%
Blackpool Council	3,000,000	183 days	0.05%
Close Brothers	5,000,000	179 Days	0.25%
Residual MMF/Call Account balances	19,527	Call	0.43%
Blackrock	5,649,203	Call	0.55%
CCLA-Deposit Fund	3,001,804	Call	0.58%
Federated Investors (Uk)	4,477,454	Call	0.50%
Goldman Sachs Asset Management	5,342,361	Call	0.51%
Hsbc Asset Management	366,029	Call	0.01%
Invesco Aim	707,471	Call	0.48%
Aberdeen Asset Management	2,088,323	Call	0.50%
Bank Of Scotland Plc	378,014	Call	0.40%
Bank Of Scotland Plc	4,108,627	32 Days	0.05%
Barclays Bank Plc	4,359,505	32 Days	0.45%
Handelsbanken Plc	901,929	35 Days	0.30%
Santander Uk Plc	4,145,032	Call	0.41%
Santander Uk Plc	4,017,746	35 Days	0.45%
Royal London Cash Plus Fund	991,193	On-going	0.67%
Ccla Property Fund	2,416,786	On-going	3.25%
Ccla Diversified Income Fund	2,018,480	On-going	2.41%
Aegon Diversified Income Fund	4,976,196	On-going	4.64%
Ninety One Diversified Income Fund	4,819,826	On-going	3.45%
Total Investments/Average Interest Rate	**67,785,505**		**1.10%**

The Strategy for 2021/22

4.19 The expectation, within the strategy for 2021/22, was that short term interest rates would decrease from 0.25% to 0.10% before increasing again to 0.5% in later years. However, in an effort to rein in inflation the Monetary Policy Committee has greatly accelerated the anticipated increase in base rates. At each of its past three meetings interest rates have been raised. December 2021 saw the base rate rise from 0.1% to 0.25%, increasing to 0.5% in February and peaking at year end to 0.75% in March 2022. The base rate today currently stands at 1% following a further increase 5 May 2022. The Council continued with the prudent investment of the treasury balances to achieve the objectives of security of capital and liquidity of its investments, whilst achieving the optimum return on investments. To mitigate any potential cash flow issues the Council's investments were placed in short-term liquid assets which have affected (and will continue to affect) the level of interest that can be achieved from investments and the underlying value of these assets.

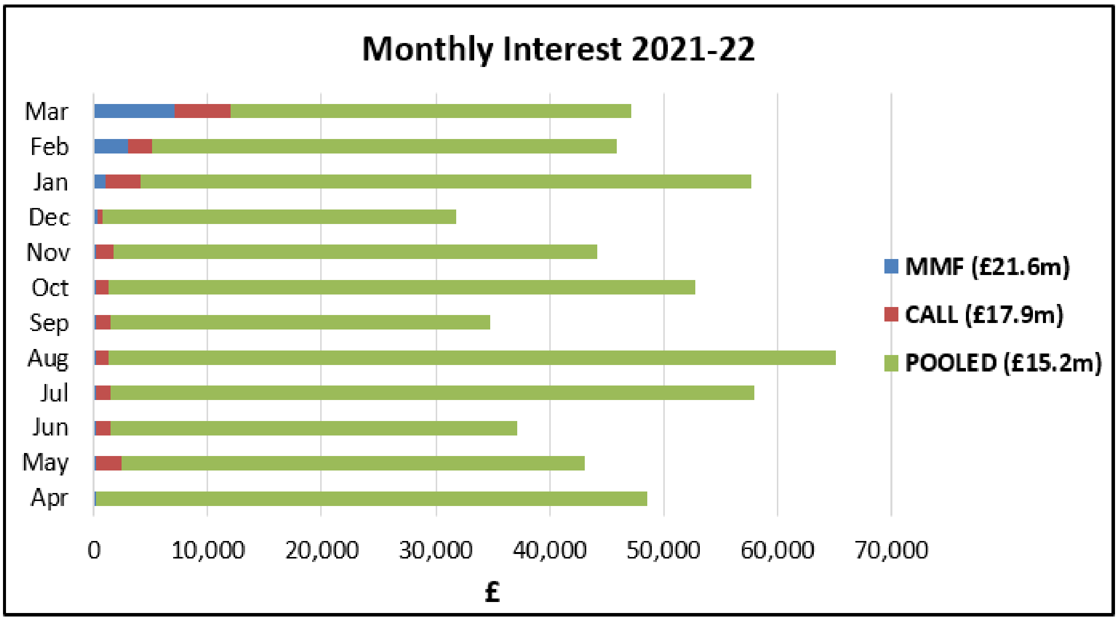
Investment Rates and Outturn Position in 2021/22

4.20 The Bank of England base rate was 0.10% at the start of the year which continued to have a significant impact on investment income, with interest rates only starting to rise in the final quarter (Dec 2021 onwards). Whilst the Council continues to ensure investments are secure, the Council is proactively looking to maximise its rate of return. The overall rate of return on investments for the year was 1.10% compared with the budgeted rate of 0.10%, and an actual rate of 0.68% in 2020/21. As well as rising interest rates, Covid grants from the

Government, additional S106 monies and underspends on the capital programme resulted in an increase in the amounts available to be invested resulting in a net return on investments of £672,742 against a budget of £417,100. (The budget had included costs of £45,000 for borrowing which didn't materialise). A positive budget efficiency of £255k to help support council services or mitigate risk. The fair value of the Council's diversified funds fell by £1.238m at 31/3/20. These values largely bounced back during 2020/21, with the values increasing by £1.143m. This year a further £2 million was invested. There continues to be fluctuations on these funds with a net favourable variance of £172,853 being reported at the end of the year. As part of the Final Outturn Report going to Cabinet it is proposed to appropriate funds into a reserve to cushion any adverse fluctuations in the capital value, where currently a statutory override prevails preventing adverse values impacting upon the Council's revenue account. This is due to stop from 1 April 2023.

Fair Value	**31.03.2021**	**Investment 2021-22**	**31.03.2022**
Aegon (previously Kames)	3,989,037	1,000,000	4,976,196
Ninety One (previously Investec)	4,069,297	1,000,000	4,819,826
RLAM	1,006,286		991,193
CCLA Property	2,055,925		2,416,786
CCLA Divesified	1,929,083		2,018,480
	13,049,628	**2,000,000**	**15,222,481**

4.21 Although the Council's diversified funds are subject to fluctuations in capital value, they provide exceptional returns into the revenue accounts. The graph below shows monthly returns from different accounts with an indication of the average balance tied up in each in 2021/22 and a similar picture applies to previous years.



4.22 The Council's investment policy is governed by the annual Capital and Investment Strategy approved by Council on 4 March 2021 (and prior to this approved by the Governance Scrutiny Group on 4 February 2021). This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, for example, rating outlooks and credit default swaps information. The investment activity during the year conformed to the approved strategy and the Council had no liquidity difficulties.

4.23 The Council's longer-term cash balances comprise primarily of revenue and capital resources, although these will be influenced by cash flow considerations and the need for working balances and contingencies. The Council's core cash resources are detailed in the following table and confirm that whilst the Council has delivered a capital programme and has to operate with an increasingly constrained revenue budget, its reserves and balances have remained healthy and in a strong position given the on-going financial challenges going forward. A net transfer to earmarked reserves of £1.210m comprises: net £1.452m transferred to reserves from revenue less £0.242m reserves used for capital. Most significant transfer to reserves is £1m for a newly established vehicle replacement reserve. There is an increase in usable capital receipts. These will be used to fund deferred schemes in the capital programme.

Balance Sheet Resources	31 March 2021 £000	31 March 2022 £000
General Fund Balance	2,604	2,604
Earmarked Reserves	22,365	23,575
Usable Capital Receipts	493	825
Capital Grants Unapplied	364	160
Total	**25,826**	**27,164**

Conclusion – Treasury Management

4.24 Overall, the Council has successfully achieved its objectives of ensuring investments were held with relatively secure counterparties; ensuring there was sufficient liquidity to operate efficiently and enable the delivery of objectives; and achieve a yield on investment returns given the constraints placed upon the Council (in terms of both financial market risks and the need to retain liquidity and protect capital). The economy is recovering but continues to present risks. We will continue to monitor these.

ASSET INVESTMENT STRATEGY

Overview

4.25 The Government and CIPFA recently issued new guidance on Treasury Management activity, and both continue to focus on the role of longer-term investments specifically held to make a commercial return. The Prudential Code has been amended so that the purchase of commercial property purely for profit cannot lead to an increased capital financing requirement (see paragraph 3.1). The Council's Asset Investment Strategy fell within the definition of the guidance, so the Council took the decision to no longer invest in property for commercial gain.

4.26 This section of the report reviews the position of existing commercial investments.

Commercial Investments 2021/22

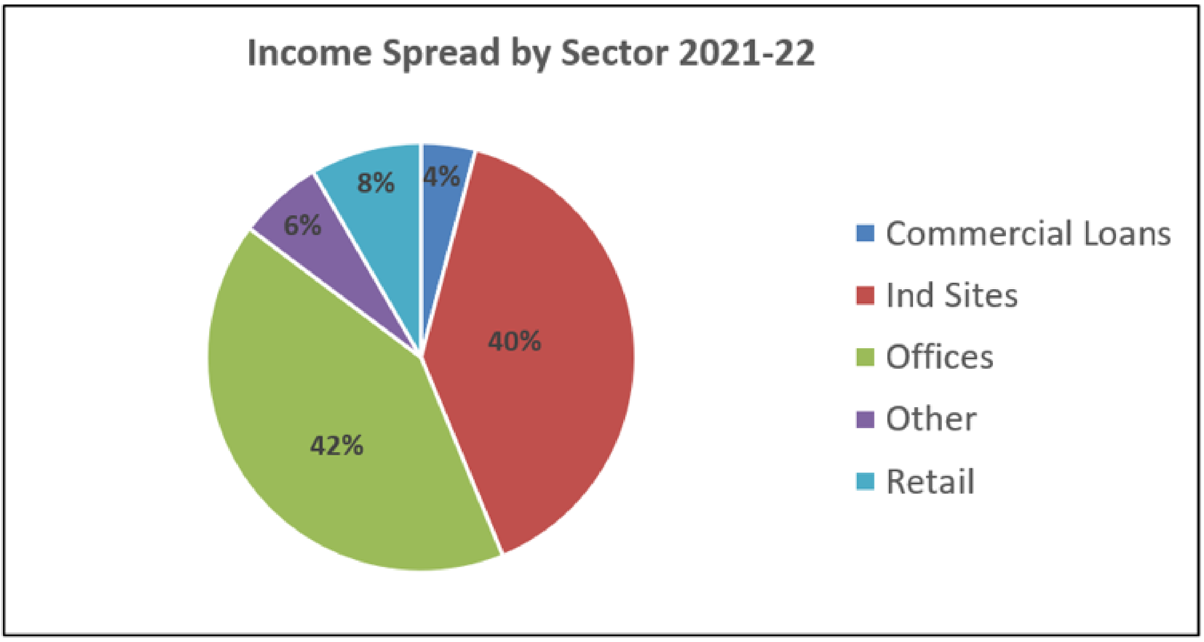
2021/22 remained an uncertain year with both Brexit and recovery from Covid impacting on the economy. No further commercial investments were pursued following the decision to remove the balance on the asset investment fund (£3.863m) as part of the MTFS (Cabinet 9 February 2021).

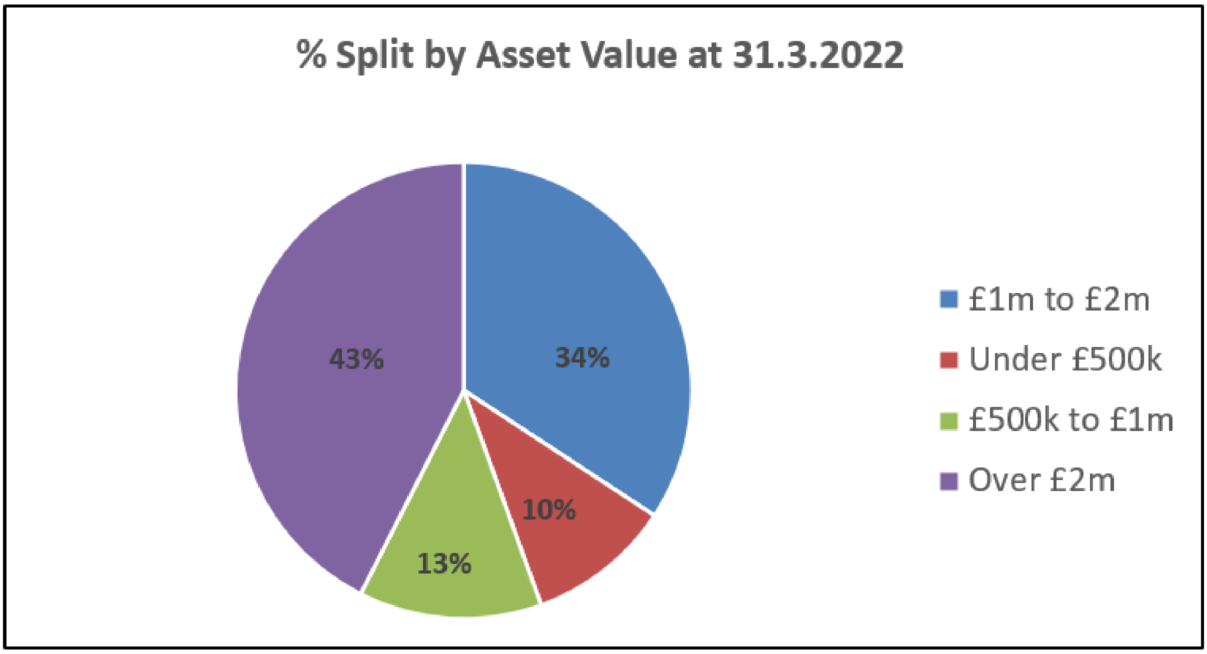
Current Position

4.27 The table below shows the returns being made on previous acquisitions from the Asset Investment Strategy. 2021-22 showed a return of 4.85% compared with 3.95% in 2020-21.

Total Spend £	**Gross Return**	**Investment**	**2021-22 £**	**2022-23 £**	**2023-24 £**	**2024-25 £**	**2025-26 £**	**2026-27 £**
1,964,500	3.28%	NCCC Loan (interest)	58,742	67,700	64,400	60,500	56,800	56,800
1,477,500	4.67%	Trent Boulevard (Co-op)	69,000	69,000	69,000	69,000	69,000	69,000
984,000	6.76%	Finch Close	66,504	66,500	66,500	66,500	66,500	66,500
1,917,000	6.26%	Bardon	120,000	120,000	120,000	120,000	120,000	120,000
2,500,000	6.20%	Cotgrave - New Offices	42,801	40,000	40,000	40,000	40,000	40,000
		& Cotgrave- Ind Units	110,121	115,000	115,000	115,000	115,000	115,000
860,000	6.98%	Boundary Court	45,761	60,000	60,000	60,000	60,000	60,000
1,900,000	4.79%	Cotgrave Phase 2	24,147	75,000	91,000	91,000	91,000	91,000
2,450,790	5.59%	Unit 3 Edwalton Business	135,256	136,900	136,900	136,900	136,900	136,900
2,083,364	5.28%	Unit 1 Edwalton Business	110,000	110,000	110,000	110,000	110,000	110,000
16,137,154	**4.85%**	**Totals**	**782,332**	**860,100**	**872,800**	**868,900**	**865,200**	**865,200**
3,862,846	**RETURNED**							

4.28 If we look at the Council's overall property portfolio there is a good spread of risk (classifying by the rental earned or the asset value), as depicted below:





4.29 Historically the Council has tended to invest more in the industrial sector given much of the property investment has been about economic growth and regeneration within the Borough. More recent acquisitions been in other sectors such as in retail and office accommodation, spreading the risk from income streams.

4.30 In terms of risk in relation to the Council's budget, the following table demonstrates that whilst property income is important for the Council's budget; there is not an over emphasis upon property income and there are other income streams. This is in keeping with the Council's Treasury Management Strategy where the objective is that the ratio of investment income as a proportion of the Council's income does not exceed 30%. The actual for the current year is significantly lower due to additional income streams in the year. Income has been positive against a range of income streams including Government Grants, Investment income and recycling credits.

Commercial Investment income and costs

	2021/22 £'000	2021/22 ACTUAL	2022/23 £'000	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000
Commercial Property Income	(1,660)	(1,712)	(2,100)	(2,286)	(2,356)	(2,430)	(2,432)
Running Costs	516	569	666	637	626	635	635
Net Contribution to core functions	(1,144)	(1,143)	(1,434)	(1,649)	(1,730)	(1,795)	(1,797)
Interest from Commercial Loans	(89)	(59)	(81)	(72)	(64)	(59)	0
Total Contribution	(1,233)	(1,203)	(1,515)	(1,721)	(1,794)	(1,854)	(1,797)
Sensitivity:							
+/- 10% Commercial Property Income	166	171	210	229	236	243	243
Indicator:							
Investment Income as a % of total Council Income	22.6%	18.1%	23.0%	24.2%	24.1%	24.5%	23.9%
Total Income	7729.3	9772	9484.3	9736.3	10042	10155.1	10182.4

The Way Forward

4.31 The Council's original intention was to look at generating around £1m of additional property rental income to help bridge the anticipated budget deficit. However last year, the AIG decided to rein in its commercial investment activity given risks within the property market and the amount of capital investment required. Recent changes regarding PWLB lending terms prevent Local Authorities from borrowing if they have any commercial activity in their MTFS. Investment income as a result of the Asset Investment Strategy (AIS) will reach it's full year effect in 2023/24 (see table at paragraph 4.27).

Member and Officer Training

4.32 The updated TM Code requires Local Authorities to document a formal and comprehensive knowledge and skills schedule reflecting the need to ensure that both members officers dealing with treasury management are trained and kept up to date. This will require a suitable training process for members and officers. There will be specific training for members training involved in scrutiny and broader training for members who sit on full Council. Previously these needs have been reported through the Member Development Group.

Now Cipfa will require a tailored, recorded and monitored training schedule to ensure that training provided achieves the desired outcomes. Members will shortly be asked to complete a survey to assess training needs.

4.33 Later in the year Link (the Council's treasury advisers) will once again be providing treasury training to all Councillors.

Conclusion

4.34 The position on all Council investments, whether treasury or commercial investments, remains fluid. Clearly risks remain in the treasury markets, the property market and also with the Council's Capital Programme. The economy, monetary measures the future remain uncertain and will be monitored closely. A quarterly update will be presented to this group showing the position for the first three months of 2022-23.

5 Risk and Uncertainties

5.1 The report covers many treasury risks including counterparty, interest rate risk, changes in Fair Value and also property risks both unique to individual properties and the wider strategic view of property. The Council is mindful of the impact of Covid-19 recovery and its effect on different asset classes including investment properties, office accommodation, retail etc. It is important that the Council continues to mitigate risk by having a diversified asset investment portfolio and other income streams, so it is not over reliant on property income (paragraphs 4.28-4.30).

5.2 The impact of high inflation has necessitated rising interest rates. Such volatility creates further risk when investing or borrowing. The treasury team continues to monitor the position on interest rates before making investment or borrowing decisions.

6 Implications

6.1 Financial Implications

Financial implications are covered in the body of the report.

6.2 Legal Implications

This report supports compliance with the Local Government Act 2003.

6.3 Equalities Implications

None.

6.4 Section 17 of the Crime and Disorder Act 1998 Implications

None.

7 Link to Corporate Priorities

Quality of Life	Efficient and effective treasury and asset investment management supports all of the Council's corporate priorities
Efficient Services	
Sustainable Growth	
The Environment	

8 Recommendations

8.1 It is RECOMMENDED that the Governance Scrutiny Group agrees the 2021/22 outturn position.

For more information contact:	Name; Peter Linfield Director – Finance and Corporate Services 0115 914 8439 email plinfield@rushcliffe.gov.uk
Background papers Available for Inspection:	Statement of Accounts 2021/22; Capital and Investment Strategy 2021/22; Treasury Management Update – Mid-Year Report 2021/22
List of appendices (if any):	Appendix 1 - Glossary of Terms

Appendix 1

Glossary of Terms

Money Market Funds – these funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks.

CCLA Property Fund - this a local authority property investment fund. The property fund is designed to achieve long term capital growth and a rising income from investments in the commercial property sector.