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| Rushcliffe Borough Council | **Governance Scrutiny Group**<br><br>**Tuesday, 1 November 2022**<br><br>**Capital and Investment Strategy – Quarter 1 2022/23** |

**Report of the Director - Finance and Corporate Services**

## 1. Purpose of report

1.1. The purpose of this report is to summarise the capital and investment activities of the Council for the period 1 April to 30 June 2022.

1.2. The Capital and Investment Strategy for 2022/23, approved by Council on 3 March 2022, outlines the Council's capital and investment priorities as follows:

- Security of capital
- Liquidity of investments; and
- Optimising yield earned on investments (cash and property).

1.3. The strategy includes indicators that help ensure that the Council's capital investment plans are affordable, prudent and sustainable. Setting an integrated Capital and Investment Strategy is a requirement of the CIPFA Code of Practice.

## 2. Recommendations

It is RECOMMENDED that the Governance Scrutiny Group notes the Capital and Investment Strategy up-date position as of 30 June 2022.

## 3. Reasons for Recommendation

3.1 CIPFA's new edition of the Code of Practice for Treasury Management (2021) recommends that Councillors should be informed of Treasury Management activities quarterly (previously twice a year). This report, therefore, ensures this Council is embracing best practice for the scrutiny of capital and investment activity in accordance with the Code of Practice CIPFA, although authorities are allowed to defer introducing revised reporting requirements until 2023/24 (these include changes in capital strategy, prudential indicators and investment reporting).

3.2 The main changes in the Treasury Management Code besides more frequent monitoring are that there should be specific training for members involved in scrutiny and broader training for members who sit on full council, and the introduction of a Liability Benchmark to manage debt. RBC will shortly be conducting a skills audit to identify specific training needs in line with the code. Together with changes in the Prudential Code there is a greater focus on climate and environmental, social and governance risks when making financial decisions.

## 4. Supporting Information

### Economic Forecast

4.1. The UK is currently experiencing a deteriorating economic outlook with prices currently rising 9.4% a year and the Bank of England warning that inflation might reach 12% within months, as the prices of fuel, energy and food put pressure on household budgets.

4.2. The Bank of England Monetary Policy Committee (MPC) reacted to this by increasing the base rate from 1% to 1.25% in June, followed by a further 0.5% increase in August, and the latest 0.5% increase in September taking the base rate to its current level of 2.25%.

4.3. Link Group (the Council’s Treasury Advisors) reacted to this by revising its interest rate forecast through a series of stepped increases. They were forecasting a further 1.5% increase over the next 9 months, peaking at 2.75% March 23. In light of the September increase in base rate Link are now forecasting interest rates to increase to 4% by Christmas and 5% by March 23.

4.4. Overall, the short-term outlook for the economy looks uncertain. The new prime minister is facing soaring inflation with consumers and businesses paying a higher price for Russia’s invasion of the Ukraine, and there is heightened risk of a recession across Europe and America.

### Investment Income

4.5. Based on Link’s base rate forecast of 0.5% at the time, the Council budgeted to receive £673,300 in investment income in 2022/23 compared with £462,100 in 2021/22. Actual interest earned to 30 June 2022 totalled £349,100 with total receipts for the year now expected to be approximately £1.192m (£676,742 in 2020/21). Interest receipts are higher than estimated due to higher interest rates and larger investment balances, due to re-profiling of the capital programme and additional S106 monies. All investments have been made in accordance with the Council’s Capital and Investment Strategy.

4.6. In order to maintain returns and mitigate risks, the Council has continued to diversify its investments mix. As a result, the Council is currently placing deposits in Money Market Funds (MMFs), Call Accounts, CCLA Property Fund, UK Local Authorities and Diversified Funds with a larger amount than normal being held in MMFs to ensure liquidity.

4.7. The table below highlights the level of investment activity and the rates obtained as at 30 June 2022. Investments were made in line with Link’s approved counterparty list.

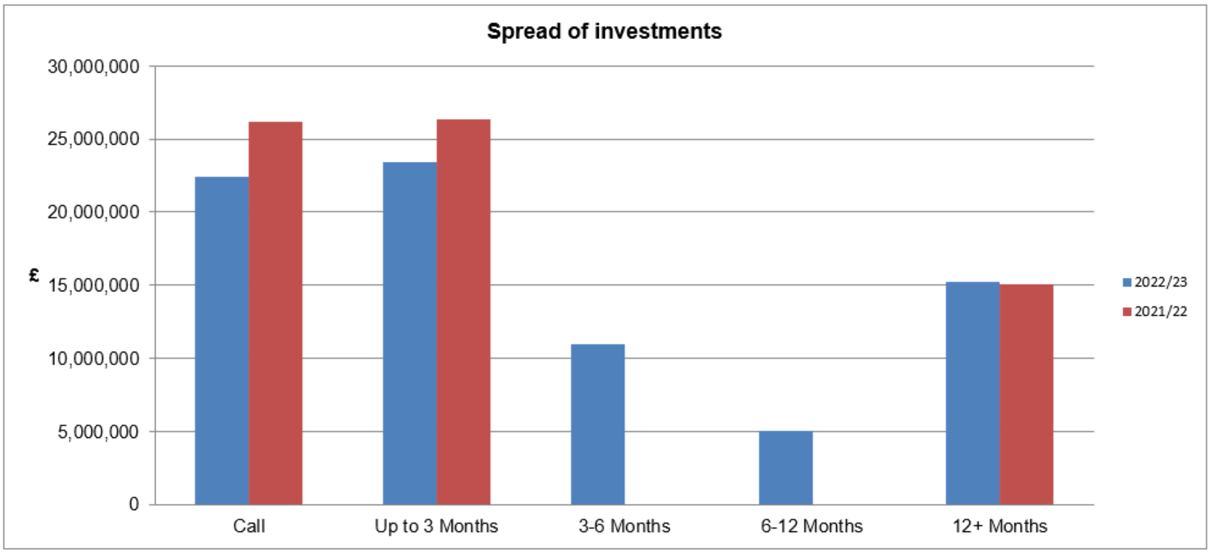
| Financial Institution | Amount £ | Length of Investment | Interest |
|---|---|---|---|
| Goldman Sachs Asset Management | 5,000,000 | 183 days | 2.15% |
| Standard Chartered | 3,000,000 | 185 days | 1.44% |
| Close Brothers | 5,000,000 | 179 days | 0.40% |
| Blackpool | 5,000,000 | 196 days | 1.15% |
| South Somerset | 3,000,000 | 212 days | 0.85% |
| Wrexham | 5,000,000 | 61 days | 0.98% |
| Blackrock | 1,233,362 | Call | 1.07% |
| CCLA -Psdf | 3,004,536 | Call | 1.02% |
| Federated | 499,943 | Call | 1.12% |
| Goldman Sachs Asset Management | 4,288,798 | Call | 1.07% |
| HSBC | 700,041 | Call | 0.01% |
| Invesco | 5,179,285 | Call | 1.12% |
| Aberdeen Asset Management | 2,990,289 | Call | 1.08% |
| Bank of Scotland | 378,376 | Call | 0.65% |
| Bank of Scotland | 4,109,111 | 32 Days | 0.15% |
| Barclays Bank | 4,364,212 | 32 Days | 0.95% |
| Handelsbanken | 901,929 | 35 Days | 0.65% |
| Santander UK | 4,147,873 | Call | 0.08% |
| Santander UK | 4,019,859 | 35 Days | 0.49% |
| Residual MMF/Call Account balances | 19,525 | Call | 0.64% |
| Royal London Cash Plus Fund | 991,193 | On-going | 1.38% |
| CCLA Property Fund | 2,416,786 | On-going | 4.58% |
| CCLA Diversified Income Fund | 2,018,480 | On-going | 4.58% |
| Aegon Diversified Income Fund | 4,976,196 | On-going | 5.01% |
| Ninety One Diversified Income Fund | 4,819,826 | On-going | 4.07% |
| **Total Investments/Average Interest Rate** | **77,059,620** | | **1.51%** |

4.8. As the table above indicates, investments as of 30 June 2022 totalled £77.059m compared with £65.516m in June 2021/22. The average rate of interest was 1.51%, higher than previous year (0.95% 2021/22). This is partly because funds available for investment exceeded those in the preceding year and partly reflects increases in interest rates. The rates achieved vary between different institutions, for different durations, dependant on when the investment was made.

4.9. In light of these cash balances, the Council continues to internally borrow to fund capital expenditure. Whilst the Council continues to ensure investments are secure and liquidity is achieved (in light of uncertain income streams), it is proactively looking to maximise its rate of return.

4.10. It should be noted that £39.6 million of the above investments relate to funds held in relation to Section 106 and CIL Agreements that are yet to be released by the Council. As part of the agreement, interest has to be paid over once funds are released. The budget assumes interest amounts on these monies will be approximately £90,000 although with higher balances and higher interest rates current projections are £598,200.

4.11. The graph below depicts our investment spread showing the range of investments over the different time periods, balancing both cash flow risk and counterparty risk. It shows a greater spread of investments in 2022/23 as last year, Councils were sitting on larger cash balances due to Covid 19 grant funding and where not looking to borrow during the 3 to 6 months window. To ensure liquidity, RBC continues to hold considerable sums, over the short term, with a greater number of institutions. This is compliant with the Council's Capital and Investment Strategy and recommended action by the Council's Treasury advisors.




4.12 The fair value of the Council's diversified funds can fluctuate. The table below shows the current position at the end of June. These funds represent less than 20% of total cash balances but contribute over 78% of the total interest received from Treasury Management investments (generating £531,264 interest in 2021/22). These investments will continue to fluctuate in value so are intended to be held long term. Currently there is a statutory override preventing any accounting loss impacting on the revenue accounts. This is due to end next 31 March 2023, however DLUHC are consulting before deciding whether this override will be made permanent. To mitigate this risk the Council, when it can, will ensure the Organisation Stabilisation reserve is increased to meet any capital losses. It is expected the values will normalise over time and the values will rise and at this point reserves would be replenished.

| Fair Value | 31.03.2021 | 30.06.22 | Difference |
|---|---|---|---|
| Aegon-Previously Kames | 4,976,196 | 4,425,213 | -550,983 |
| Ninety One-Previously Inves | 4,819,826 | 4,538,071 | -281,755 |
| RLAM | 991,193 | 982,352 | -8,841 |
| CCLA Property | 2,416,786 | 2,543,095 | 126,309 |
| CCLA Divesified | 2,018,480 | 1,887,902 | -130,578 |
| | **15,222,481** | **14,376,633** | **-845,848** |

**Borrowing**

4.12. In accordance with the Local Government Act 2003, the Council has a statutory duty to determine and keep under review how much it can afford to borrow. Therefore, the Council establishes 'Affordable Borrowing Limits' (or Authorised Limit) as part of the Prudential Indicators within the approved Capital and Investment Strategy Statement.

4.13. The 'authorised limit' and 'operational boundary' indicators govern the maximum level of external borrowing to fund the capital programme and short-term cash flow.

4.14. The need to borrow is anticipated to be £5.5m in 2022/23 although the Council will use internal resources as opposed to externally borrow. The Operational Boundary set for the year is £20m (see **Appendix A**). The Authorised limit is set at £25m and any change in this would require Full Council approval.

4.15. The TM Code introduces a new indicator called the Liability Benchmark which reflects the real need to borrow. This benchmark illustrates that the Council has no need to borrow over the medium term (ie existing resources exceed the underlying need to borrow).

| | 2022/23 £'000 | 2022/23 Projection | 2023/24 £'000 | 2024/25 £'000 | 2025/26 £'000 | 2026/27 £'000 |
|---|---|---|---|---|---|---|
| Closing CFR | 14,933 | 11,766 | 11,548 | 11,054 | 9,717 | 8,815 |
| **Less:** | | | | | | |
| Usable Reserves | (22,701) | (23,775) | (18,598) | (19,000) | (17,446) | (16,386) |
| Working Capital | (23,149) | (40,603) | (38,603) | (36,603) | (34,603) | (32,603) |
| Plus minimum investments | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| **LIABILITY BENCHMARK** | (20,917) | (42,612) | (35,653) | (34,549) | (32,332) | (30,174) |

4.16. As part of the Capital and Investment Strategy, the Council established a range of Prudential Indicators (which also accords with professional practice) to monitor both Treasury and Capital as the two are intrinsically linked. Details of the performance against the Prudential Indicators can be found at Appendix A. Key comments to note are as follows:

(a) Capital Expenditure – The original budget for 2022/23 was £14.611m, with £10.646m carry forwards and other adjustments of £0.146 giving a current budget of £25.403m. The projected outturn is around £19.2m – resulting in an estimated underspend of £6m primarily due to Support for Registered Housing Providers not wholly committed - £1.894m; potential savings on and Bingham Hub (£1m); and agreed re-profiling of expenditure on operational land and buildings to 2023/24 £1.465m, this position is reported to both Cabinet and Corporate Overview Group.

(b) Financing costs to net revenue stream – improved position anticipated due to higher investment returns due to larger balances and higher interest rates.

(c) Expected investment position – higher due to rephasing of the capital programme and additional S106 monies.

(d) Capital Financing Requirement (CFR) – the closing position will be less than budgeted for as a result of capital programme re-phasing as mentioned at (a) above. The CFR projected end of year position is £11.766m.

**Commercial Investments**

4.17. The Council has to disclose its dependence on commercial income and the contribution non-core investments make towards core functions. This covers assets purchase through the Council's Asset Investment Strategy, as well as pre-existing commercial investments.

4.18. The expected contributions from commercial investments are shown below. In order to manage the risk to the Council's budget, income from commercial investments should not be a significant proportion of the Council's income. It is estimated to be around 20% in the current year. The Council has set a target that this ratio should not exceed 30% in future years, subject to annual review.

**Commercial Investment income and costs**

| 2022/23 | Original £'000 | Current £'000 | Actual £'000 | Projected £'000 |
|---|---|---|---|---|
| **Commercial Property Income** | (1,772) | (1,772) | (447) | (1,709) |
| **Running Costs** | 616 | 617 | 179 | 617 |
| **Net Contribution to core functions** | (1,156) | (1,155) | (268) | (1,092) |
| **Interest from Commercial Loans** | (81) | (110) | (4) | (105) |
| **Total Contribution** | (1,237) | (1,265) | (272) | (1,197) |
| **Sensitivity:** | | | | |
| +/- 10% Commercial Property Income | 177 | 177 | 45 | 171 |
| **Indicator:** | | | | |
| Investment Income as a % of total Council Income | 19.5% | 22.8% | 19.0% | 19.1% |
| Total Income | 9,484 | 9,484 | 2,371 | 9,484 |

## 5 Conclusion

5.1. Treasury Management continues to be fraught with difficulty. The UK economy is recovering but risk of a recession remains real with inflationary pressures and rising interest rates. Whilst the latter will have a positive effect on returns that can be achieved from investments, uncertainty in the economy will have a negative impact on the capital value of some of RBC's investments. As normality returns then it is expected a positive impact on asset values will materialise. Changes in accounting codes will restrict what local authorities can do coupled with the threat of borrowing caps. Officers will continue to be vigilant and report any significant issues to the Governance Scrutiny Group.

## 6 Risk and Uncertainties

6.1. The report covers both counterparty, interest rate and property related risks.

## 7 Implications

### 7.1. Financial Implications

Financial Implications are covered in the body of the report.

### 7.2. Legal Implications

There are no specific legal implications identified in this report. The report demonstrates the Councils good practice in following CIPFA's Code of Practice for Treasury Management (2021) recommends by informing Councillors of Treasury Management activities quarterly. Adoption of the best practice ensures scrutiny of capital and investment activity undertaken during the relevant period.

### 7.3. Equalities Implications

There are no equalities implications identified for this report

### 7.4. Section 17 of the Crime and Disorder Act 1998 Implications

There are no implications identified for this report

## 8 Link to Corporate Priorities

| | |
|---|---|
| Quality of Life | The recommendations in this report do not impact on or contribute to the Council's Quality of Life priority. |
| Efficient Services | Responsible income generation and maximising returns |
| Sustainable Growth | The recommendations in this report do not impact on or contribute to the Council's Sustainable Growth priority. |
| The Environment | Helping to protect the environment by consideration of carbon footprint and fossil-based investments as part of the Capital and Investment Strategy |

## 9 Recommendations

It is RECOMMENDED that the Governance Scrutiny Group notes the Capital and Investment Strategy update position at 30 June 2022.

| | |
|---|---|
| **For more information contact:** | Peter Linfield<br>Director - Finance and Corporate Services<br>0115 914 8439<br>plinfield@rushcliffe.gov.uk |
| **Background papers available for inspection** | Treasury Management Strategy 2022/23 |
| **List of Appendices (if any):** | Appendix A – Prudential and Treasury Indicators for 2022/23 position at 30 June 2022 |

## APPENDIX A

# Prudential and Treasury Indicators for 2022/23
# Position at 30 June 2022

| | 2022/23 £'000 Original Estimate | 2022/23 £'000 Projected |
|---|---|---|
| **Prudential Indicators** | | |
| **Capital Expenditure** | 14,611 | 25,403 |
| **Proportion of financing costs to net revenue streams** | 5.29% | 3.01% |
| **Expected Investment Position (at 31 March 2023)** | 30,917 | 52,612 |
| **Capital Financing requirement as at 31 March 2023** | 14,933 | 11,766 |
| **Treasury Management Indicators** | | |
| **Authorised Limit for external debt** Borrowing and other long-term liabilities | 25,000 | 25,000 |
| **Operational Boundary for external debt** Borrowing and other long-term liabilities | 20,000 | 20,000 |
| **Upper limit for fixed interest rate exposure on investments up to 1 year** | 50% | 50% |
| **Upper limit for variable rate exposure (investments)** | 100% | 100% |
| **Upper limit for total principal sums invested over 1 year** | 15,400 | 16,900 |

## 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.

Covered Bonds – these investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means they are exempt from bail-in.

Pooled Funds – shares in diversified investment vehicles consisting of different investment types including banks, equity shares and property, these funds have the advantage of providing wide diversification of investment risks

LIBID – London Inter Bank Bid Rate. The rate at which banks are willing to borrow from other banks