Rushcliffe Borough Council	**Governance Scrutiny Group** **Thursday, 24 November 2022** **Capital and Investment Strategy – Mid-Year Report 2022/23**

Report of the Director - Finance and Corporate Services

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 September 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 September 2022.

3. Reasons for Recommendation

3.1 CIPFA's updated Code of Practice for Treasury Management (2021) recommends that Councillors should be informed of Treasury Management activities quarterly. This report, is the second report for 2022-23..

3.2 As previously reported, the updated Treasury Management Code included a requirement for specific training for members involved in scrutiny and broader training for members who sit on full council. Members have received a Knowledge and Skills Framework questionnaire (due for return on 1 November). This is a pilot which will inform the questionnaire going forward and for new members on CGG after the local elections in May 2023, to be used to assess and tailor training needs in line with the code.

4. Supporting Information

Economic Forecast

4.1. The UK continues to experience uncertainty and a weakening in the economy. Prices have continued to rise, with the CPI for September rising to 10.1%. Inflation has not peaked yet, but the Bank of England are warning that inflation might reach 12% by next April. The early end to the utility price cap means that the average inflation rate forecast for next year is more likely to be 9% rather than 6%.

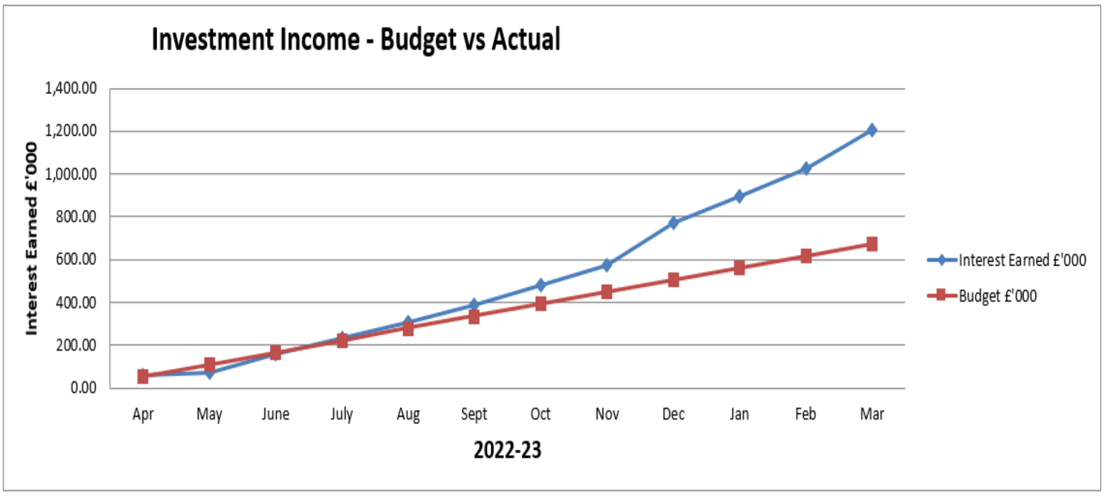
4.2. The current Bank of England base rate has just increased from 2.25% to 3% (Monetary Policy Committee 4th November). The markets are expecting the Base Rate to climb to 5.25%, not a million miles away from Link Group (the Council's Treasury Advisors) forecasts of 4% by Christmas and 5% by March 23.

4.3. Overall, the short-term outlook for the economy remains uncertain as we continue to head into an economic downturn. 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

4.4. 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 September 2021 totalled £491,600 (£349,100 at 30 June) with total receipts for the year now expected to be approximately £1.264m (£676,742 in 2021/22). 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.

4.5. The projected return on investments is highlighted in the following graph, which depicts the performance against the budget.



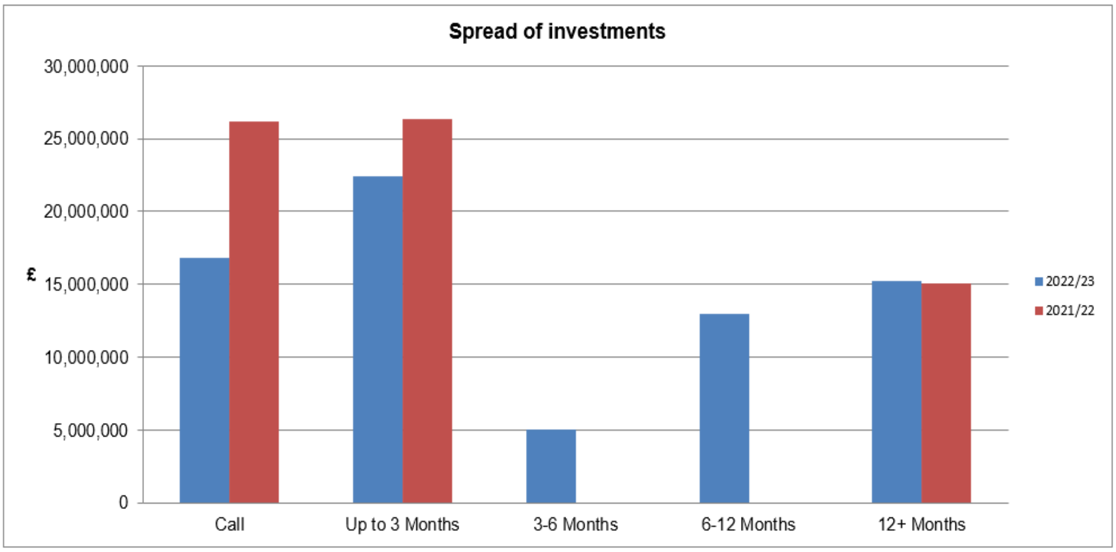
4.6. In order to maintain returns and mitigate risks, the Council has continued to diversify its investments mix. As a result, the Council is currently placing deposits in Money Market Funds (MMFs), Call Accounts, CCLA Property Fund, UK Local Authorities and Diversified Funds with a larger amount than normal being held in MMFs to ensure liquidity. The table below highlights the level of investment activity and the rates obtained at 30 September 2022. Investments were made in line with Link's approved counterparty list.

Financial Institution	Amount £	Length of Investmen	Interest
Goldman Sachs Asset Management	5,000,000	183 days	2.15%
Standard Chartered	3,000,000	185 days	1.44%
Blackpool Council	5,000,000	196 days	1.15%
Close Brothers	5,000,000	179 days	0.40%
South Somerset	3,000,000	212 days	0.85%
Wrexham	5,000,000	61 days	0.98%
East Hertfordshire	5,000,000	273 days	2.83%
Residual MMF/Call Account Balances	19,071	Call	0.30%
Blackrock	122,891	Call	2.01%
Ccla - Psdf	371,819	Call	1.95%
Federated Investors (Uk)	2,854,290	Call	2.09%
Goldman Sachs Asset Management	128,641	Call	1.98%
Hsbc Asset Management	356,055	Call	0.01%
Invesco Aim	3,954,398	Call	2.12%
Aberdeen Asset Management	4,488,456	Call	2.10%
Bank Of Scotland Plc	378,920	Call	0.01%
Bank Of Scotland Plc	109,570	32 Days	0.80%
Barclays Bank Plc	4,375,844	32 Days	1.70%
Handelsbanken Plc	902,777	35 Days	0.95%
Santander Uk Plc	4,154,267	Call	0.83%
Santander Uk Plc	4,031,325	35 Days	0.78%
Royal London Cash Plus Fund	991,193	On-going	2.96%
Ccla Property Fund	2,416,786	On-going	3.09%
Ccla Diversified Income Fund	2,018,480	On-going	2.79%
Aegon Diversified Income Fund	4,976,196	On-going	5.80%
Ninety One Diversified Income Fund	4,819,826	On-going	5.70%
Total Investments/Average Interest Rate	**72,470,805**		**2.16%**

4.7. As the table above indicates, investments as of 30 September 2022 totalled £72.471m compared with £64.779m in 2021/22. Whilst the Council continues to ensure investments are secure and liquidity is achieved, it is proactively looking to maximise its rate of return. The average rate of interest was 2.16% (1.51% 30 June), higher than previous year (1.16% 2020/21). This reflects increases in the base rate and also funds available for investment exceeded those in the preceding year. The rates achieved vary between different institutions, for different durations, dependant on when the investment was made.

4.8. It should be noted that £40.8 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 (0.05%) although with higher balances and higher interest rates (rising to 2%) current projections are £598,400.

4.9. 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 than last year when Councils were concerned with liquidity due to Covid 19 grant funding and were not looking to borrow during the 3 to 6 months window. Whilst liquidity remains a priority the Council will now look to spread more of its investments over the 3 to 6 month period over the coming months. This is compliant with the Council's Capital and Investment Strategy and recommended action by the Council's Treasury advisors.



4.10. The average interest rates achieved so far this year on the Council's investments are compared to the Sterling Overnight Index Average (SONIA) rates. £26m of RBC's investments are held in MMF/Call accounts. Interest rates earned on these accounts tend to lag behind movements in the base rate, although the trend tends to be the same. The Council also holds £31m in temporary investments which vary in duration. These earn a fixed rate of interest set at commencement of the investment so again do not immediately reflect changes in interest rates. RBC also holds just over £15m in diversified income and property accounts which are held long term (12 Months +). These are high earning accounts currently earning an average a rate of 4.75% in interest but are subject to fluctuations in capital value as discussed below in paragraph 4.11.

Benchmark	SONIA (September 2022)	Council Performance
1 Month	2.23%	1.22%
3 Months	2.75%	-
6 Months	3.40%	1.63%
12 Months +	4.12%	4.75%

4.11 The fair value of the Council's diversified funds can fluctuate. The table below shows the current position at the end of September. These funds represent less than 21% of total cash balances but contributed over 63% of the total interest received from Treasury Management investments last year (generating £531,264 interest in 2021/22). These investments will continue to fluctuate in value so are intended to be held long term rather than incur a loss at this moment in time. To mitigate the risk to the Council of movement in Capital values, the Q2 report to Corporate Overview Group and Cabinet in

November and December, respectively, recommends £0.66m to be earmarked (in addition to the £0.2m earmarked from 2021/22 efficiencies). It is expected the values will normalise over time and the values will rise. At this point this reserve is available to be appropriated to other reserves (and mitigate other risks).

Fair Value	31.03.2022	30.06.22	30.09.22	Difference
Aegon-Previously Kames	4,976,196	4,425,213	4,145,841	-830,355
Ninety One-Previously Inves	4,819,826	4,538,071	4,401,865	-417,961
RLAM	991,193	982,352	965,030	-26,162
CCLA Property	2,416,786	2,543,095	2,435,135	18,349
CCLA Divesified	2,018,480	1,887,902	1,845,419	-173,061
	15,222,481	**14,376,633**	**13,793,290**	**-1,429,190**

4.12. The Council monitors its carbon footprint and over the longer term aims to divest from fossil fuel investments. Currently 21% (18.5% in 2021) of our portfolio is invested in diversified funds which invest in equities and, therefore, carry a small risk of fossil fuel investments. Security, Liquidity and Yield are the Council's main priority (in accordance with the CIPFA Code for treasury investments). We currently have a sustainable fixed term deposit with Standard Chartered and have just opened an ESG liquidity account with HSBC.

Borrowing

4.13. 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.

4.14. The authorised limit represents the limit beyond which external borrowing is prohibited and is set as part of the Treasury Strategy, whereas as the operational boundary is the expected borrowing position of the Council based on the CFR and a buffer.

4.15. In light of cash balances in 4.6, the Council continues to internally borrow to fund capital expenditure and does not envisage externally borrowing during the medium term.

4.16. The need to internally borrow is now anticipated to be £9.25m in 2022/23 compared to the £5.5m projected in the Quarter 1 report. This is due to a slippage in anticipated Capital Receipts from Hollygate Lane. 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.

4.17. The Liability Benchmark reflects the real need to borrow. This benchmark, at £41m 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	15,516	10,705	9,433	8,162	7,325
Less:						
Usable Reserves	(22,701)	(23,287)	(21,152)	(20,380)	(18,886)	(17,510)
Working Capital	(23,149)	(43,569)	(38,625)	(35,750)	(33,750)	(31,750)
Plus minimum investments	10,000	10,000	10,000	10,000	10,000	10,000
LIABILITY BENCHMARK	(20,917)	(41,340)	(39,072)	(36,697)	(34,474)	(31,935)

4.18. 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 £1.079 giving a current budget of £24.178m. 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 - £1.958m (£1.5m of this is requested to be re-phased to 2024/25 while options continue to be assessed); unused contingencies on Bingham Hub (£1m) but these continue to be applied as completion/handover protracted; and requested re-profiling of expenditure on other operational land and buildings to 2023/24 £0.465m, 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 and higher interest rates.

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

(d) Capital Financing Requirement (CFR) – the closing position will be greater than predicted in the short-term, as a result of the potential delayed receipt from disposal of land at Hollygate Lane. The CFR projected end of year position is £15.516m. This will be reduced by applying the Hollygate Lane capital receipt in 2023/24.

Commercial Investments

4.19. 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.

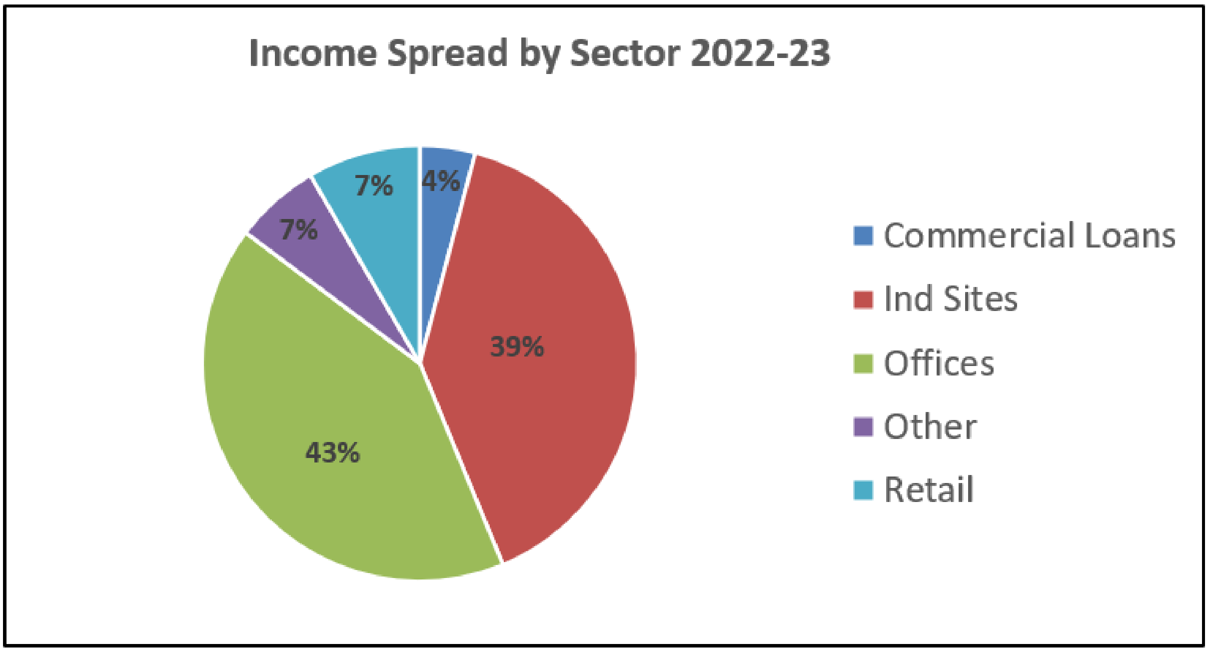
4.20. The expected contributions from commercial investments are shown below. In order to manage the risk to the Council's budget, income from commercial investments should not be a significant proportion of the Council's income. It is estimated to be around 16.3% in the current year, below budget partly due to delays in Bingham Enterprise Centre and also because overall income has risen due to treasury investments. The Council set a target that this ratio should not exceed 30% in future years, subject to annual review.

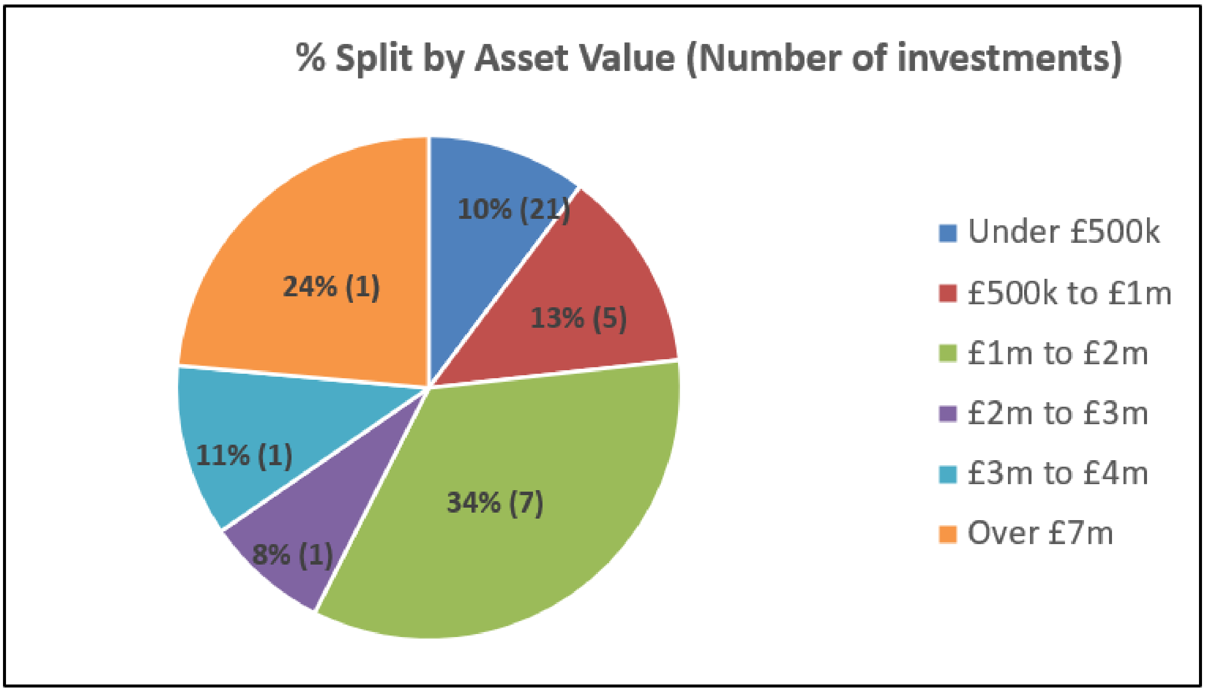
Commercial Investment income and costs

2022/23	Original £'000	Current £'000	Actual £'000	Projected £'000
Commercial Property Income	(1,772)	(1,753)	(884)	(1,661)
Running Costs	617	647	340	677
Net Contribution to core functions	(1,155)	(1,106)	(544)	(984)
Interest from Commercial Loans	(81)	(110)	(55)	(81)
Total Contribution	(1,236)	(1,216)	(599)	(1,065)
Sensitivity:				
+/- 10% Commercial Property Income	177	175	88	166
Indicator:				
Investment Income as a % of total Council Income	19.3%	22.8%	17.6%	16.3%
Total Income	9,604	10,155	5,341	10,683

Risk Exposure Indicators

4.21. The Council can minimise its exposure to risk by spreading investments across sectors and by avoiding single large-scale investments. Generally, there is a spread of investment across sectors. The Council's commitment to economic regeneration (not purely financial return) has meant that many of its investments have been in industrial units, which have been very successful. Fears that new ways of working in light of Covid would reduce demand for office accommodation have largely been unfounded, with workers returning to offices.





Security and Liquidity

4.22. Commercial investments are held for longer term asset appreciation as well as yield. Investments or sales decisions will normally be planned as part of the consideration of the 5-year capital strategy to maximise the potential return. Nevertheless, the local and national markets are monitored to ensure any gains are maximised or losses minimised.

4.23. To help ensure asset values are maintained the assets are given quarterly inspections, together with a condition survey every 3 years. Any works required to maintain the value of the property will then form part of Council's spending plans.

4.24. The liquidity of the assets is also dependent on the condition of the property, the strength of the tenants and the remaining lease lengths. The Council keeps these items under review with a view to maximising the potential liquidity and value of the property wherever possible. The last Asset Management review was reported to this group 25 November 2021 with the next review planned for autumn 2023.

4.25. The liquidity considerations for commercial investments are intrinsically linked to the level of cash and short-term investments, which help manage and mitigate the Council's liquidity risk.

Training and Development

4.26. The Council's Treasury Management Advisors, Link Asset Services held a presentation and training session to Councillors on 22 November 2021 and the next is scheduled for 17 January 2023.

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 the Council's investments. Pending the result of the consultation on the statutory override, the Council is mitigating the risk by earmarking funds from past and in-year efficiencies. 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 Council's 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	Good Treasury Management enables the Council to continue to deliver services that contribute to the quality of life of Rushcliffe residents.
Efficient Services	Responsible income generation and maximising returns and minimising exposure to borrowing costs.
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 September 2022.

For more information contact:	Peter Linfield Director - Finance and Corporate Services 0115 914 8439 plinfield@rushcliffe.gov.uk
Background papers available for inspection	Treasury Management Strategy 2022/23 Governance Scrutiny Group 1 November 2022 – Capital and Investment Strategy Q1
List of Appendices (if any):	Appendix A – Prudential and Treasury Indicators for 2022/23 position at 30 September 2022

APPENDIX A

Prudential and Treasury Indicators for 2022/23
Position at 30 September 2022

	2022/23 £'000 Original Estimate	2022/23 £'000 Current Projections
Prudential Indicators		
Capital Expenditure	14,611	19,198
Proportion of financing costs to net revenue streams	5.29%	-1.20%
Expected Investment Position (at 31 March 2023)	30,917	61,520
Capital Financing requirement as at 31 March 2023	14,933	15,516
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	30,760

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

SONIA (Sterling Overnight Index Average) – Average interest rates that banks pay to borrow sterling overnight from other financial institutions in circumstances where credit, liquidity and other risks are minimal.