Rushcliffe Borough Council	**Governance Scrutiny Group** **Thursday, 29 June 2023** **Capital and Investment Strategy Outturn 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 transactions undertaken during the 2022/23 financial year reporting against the Council's Capital and Investment Strategy 2022/23-2026/27.

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 2022/23 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 2022/23. 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 was updated December 2021. Proportionality is now included as an objective, there was clarification around the definition of commercial activity and investments, and the purchase of commercial property purely for profit cannot lead to an increased capital financing requirement (CFR). CIPFA also introduced a liability benchmark as a treasury management indicator.

4 Supporting Information

TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2022/23, 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	2021/22 Actual £000	2022/23 Estimate £000	2022/23 Actual £000
Capital Expenditure	16,276	14,611	15,419
Capital Financing Requirement	7,726	14,933	13,266
Investments	(67,785)	(30,917)	(59,914)

4.2 The approved capital programme for 2022/23 was £14.611m, with £10.646m brought forward from 2021/22 less other budget adjustments of £4.239m during the year giving a total provision for the year of £21.018m. Actual expenditure against the approved programme was £15.419m (73%) giving rise to a variance of £5.599m. Carry forwards of £5.426m have been requested by Cabinet as part of the Final Outturn Report. The decrease in the Investments balance between years is a reflection of the level of covid grants received during the pandemic.

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:

	2021/22 Actual £000	2022/23 Estimate £000	2022/23 Actual £000
Capital Expenditure	**16,276**	**14,611**	**15,419**
Less Financed by:			
Capital Receipts	(7,787)	(8,921)	(4,386)
Capital Grants	(5,747)	(4,085)	(2,790)
Reserves	(242)	(1,605)	(1,243)
Increase in Borrowing Need	**2,500**	**-**	**7,000**

Re-profiling of expenditure on Bingham Hub and the Crematorium reduced the need to borrow in 2021/22 and instead impacting on 2022/23 (£7m). All of the expenditure can be financed from the Council's capital resources and internal borrowing 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 2022/23 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 In 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 (approximately £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 2022/23 represents a key prudential indicator and is shown below. The table shows additional internal borrowing was needed in 2022/23 giving a closing balance of £13.266m after deducting the MRP of £1.017m in 2022/23.

Capital Financing Requirement (CFR)	2021/22 Actual £000	2022/23 Actual £000
Opening Balance	5,857	7,283
Add: unfinanced Capital Expenditure (per above)	2,500	7,000
Less: MRP/VRP	(1,074)	(1,017)
Closing Balance	7,283	13,266

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 2022/23 these indicators are not applicable.

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 minus figure as a result of income from investments exceeding expectations due to rising interest rates throughout the year and this exceeding MRP payments.

The Ratio of Financing Costs to Net Revenue Streams

	2021/22 Actual £000	2022/23 Estimate £000	2022/23 Actual £000
General Fund	3.43%	5.29%	-0.63%

4.16 There is a new indicator that looks at net income from commercial and service investments (for example it includes the Crematorium) and expresses it as a percentage of net revenue streams. The increase in later years reflect rent increases and full year effect of the crematorium becoming operational. The actual for 2022/23 is lower than estimated due the Crematorium not becoming operational until the spring and net revenue streams being higher due to Grant Income and Business Rates.

	2022/23 Estimate	2022/23 Actual	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Net Income to Net Revenue Stream	14.5%	11.5%	11.3%	11.4%	15.5%	15.7%	15.6%

Upper Limits for Fixed and Variable Rate Exposure

4.17 The purpose of these indicators is to allow the Council to manage the extent to which it is exposed to changes in interest rates. Investment balances dipped at year end due to a transitional payment to DLUHC (£6.238m) which resulted in in the exposure 0.2% above the limit but this was just a temporary position and although fixed rate investment remain at the same level, exposure is currently 41%

	2022/23 Limit	2022/23 Actual
Fixed Upper Limit for Fixed Interest Rate Exposure	50%	52%
Variable Upper limit for Variable Interest Rate Exposure	100%	48%

Upper Limit for Total Principal Sums invested over 1 year

4.18 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.

	2022/23 Limit £000	2022/23 Actual £000
Upper Limit for Total Principal Sums Invested over 364 days	15,400	0

Treasury Position on 31 March 2023

4.19 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 2022/23.

Financial Institution	Amount £	Investment	Interest
Standard Chartered	4,000,000	182 days	4.06%
Standard Chartered	3,000,000	183 days	4.28%
Close Brothers	5,000,000	179 days	2.00%
HSBC ECG	5,050,023	Call	3.19%
Hertfordshire District Council	5,000,000	273 days	2.83%
Brentwood Borough Council	5,000,000	102 days	3.65%
Denbighshire Council	5,000,000	92 days	3.58%
Wrexham Borough Council	5,000,000	273 days	2.48%
Residual MMF/Call Account Balances	64,166	Call	3.04%
Blackrock	1,405,592	Call	4.09%
Ccla - Psdf	103,559	Call	4.12%
Federated Investors (Uk)	352,391	Call	4.04%
Goldman Sachs Asset Management	254,619	Call	4.01%
Hsbc Asset Management	320,590	Call	0.50%
Invesco Aim	509,094	Call	4.03%
Bank Of Scotland Plc	378,937	Call	0.01%
Bank Of Scotland Plc	110,303	32 Days	2.00%
Barclays Bank Plc	4,445,714	32 Days	4.20%
Handelsbanken Plc	911,993	35 Days	2.45%
Santander Uk Plc	164,129	Call	2.63%
Santander Uk Plc	77,398	35 Days	3.53%
Royal London Cash Plus Fund	983,676	On-going	3.96%
Ccla Property Fund	2,018,374	On-going	4.36%
Ccla Diversified Income Fund	1,839,164	On-going	3.25%
Aegon Diversified Income Fund	4,364,956	On-going	6.80%
Ninety One Diversified Income Fund	4,559,707	On-going	6.20%
Total Investments/Average Interest Rate	**59,914,383**		**3.79%**

The Strategy for 2022/23

4.20 The expectation, within the strategy for 2022/23, was that short term interest rates would increase from 0.5% with incremental increases of 0.25% until peaking and remaining at 1.25% from 2025/26 onwards. However, in an effort to rein in inflation the Monetary Policy Committee has greatly accelerated the anticipated increase in base rates. At most of the meetings during 2022/23 interest rates have been raised by at least 0.25%. The base rate today currently stands at 4.5% following a further increase 11 May 2023. 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 2022/23

4.21 The Bank of England base rate was 0.10% at the start of the year with interest rates increasing to 1% in May 2022 and to 2.25% in October 2022 from which date it has continued to rise. 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 3.79% compared with the budgeted rate of 0.50%, and an actual rate of 1.10% in 2021/22. As well as rising interest rates, 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 £1,139,640 against a budget of £673,300.

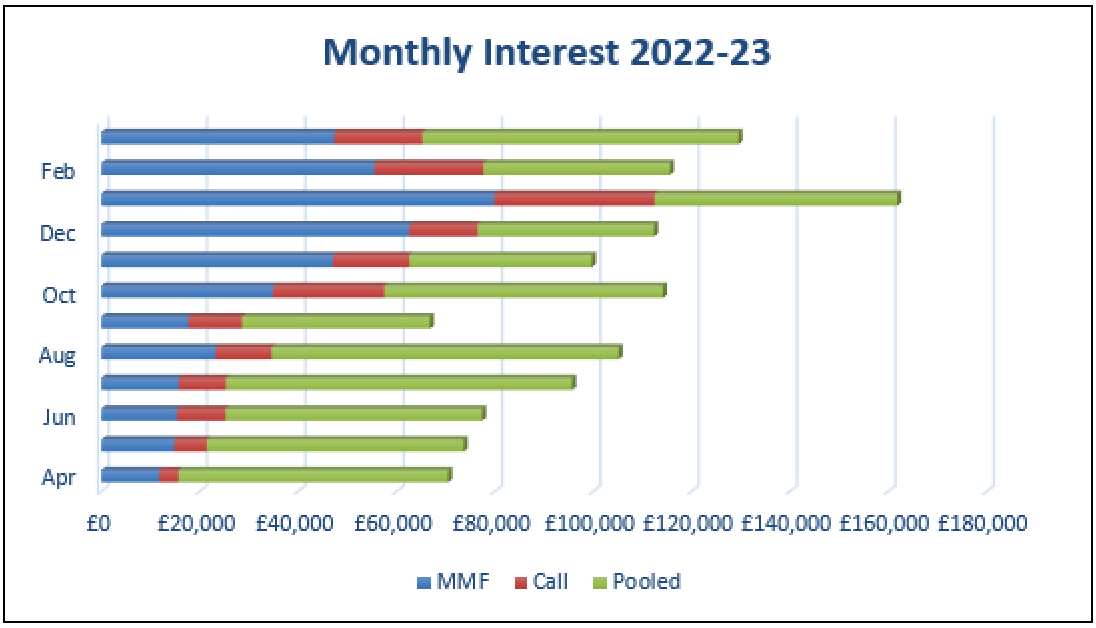
The Council's performance in comparison to (Sterling Overnight Index Average (SONIA) is shown below. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors

	Average Balance £'000	Interest £'000	Return	SONIA
1 to 3 Months	5,000	94	1.88%	1.81%
3 to 6 Months	10,549	345	3.27%	1.42%
6 Months to 1 year	23,014	787	3.42%	0.90%

4.22 The fair value of the Council's diversified funds can fluctuate. During the year the value reduced by £1.457m. To mitigate this loss, appropriations have been made to a reserve of £0.973m (see paragraph 4.25) - £0.773m from in year efficiencies and £0.2m from 2021/22, to cushion any adverse fluctuations. There is currently a statutory override, effective for a further 2 years, which prevents any accounting loss impacting on the revenue accounts. It was due to end 31st March 2023 but has been extended to 31st March 2025.

Fair Value	1.04.22	31.03.23	Difference
Aegon-Previously Kames	4,976,196	4,364,956	-611,240
Ninety One-Previously Inves	4,819,826	4,559,707	-260,119
RLAM	991,193	983,676	-7,517
CCLA Property	2,416,786	2,018,374	-398,412
CCLA Divesified	2,018,480	1,839,164	-179,316
	15,222,481	**13,765,876**	**-1,456,604**

4.23 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 a £0.620m return from £15m investment in diversified funds compared to £0.426m from an average of £20m invested in Money Markets. It should be noted that the balance invested in Money Markets fluctuates month by month.



4.24 The Council's investment policy is governed by the annual Capital and Investment Strategy approved by Council on 2 March 2023 (and prior to this approved by the Governance Scrutiny Group on 31 Feb 2023). 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.

4.25 The Council's longer-term cash balances comprise primarily 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. There has been a net transfer from earmarked reserves of £4.003m. The most significant transfer from reserves was £3.707m from the Collection Fund reserve, whilst the largest movement to reserves is £0.773m for the creation of the IFRS 9 Capital Depreciation Reserve for movements in fair values of Treasury Assets. 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 2022 £000**	**31 March 2023 £000**
General Fund Balance	2,604	2,604
Earmarked Reserves	23,575	19,572
Usable Capital Receipts	825	1,085
Capital Grants Unapplied	160	154
Total	**27,164**	**23,415**

Conclusion – Treasury Management

4.26 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 trying to restore stability and tame inflation so continues to present risks. We will continue to monitor these.

ASSET INVESTMENT STRATEGY

Overview

4.27 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.

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

Investments 2022/23

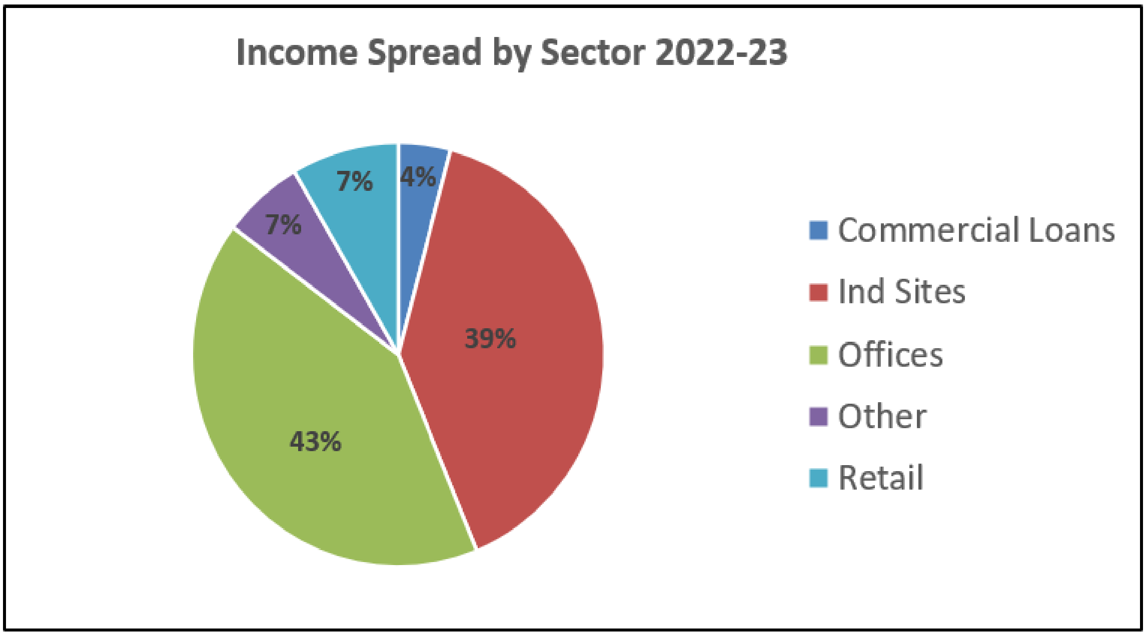
2022/23 remained an uncertain year with political unrest, spiralling inflation and counteracting interest rate rises all impacting on the economy. No further commercial investments were pursued following the decision to remove the balance on the asset investment fund (£3.863m) as part of the MTFS (Cabinet 9 February 2021).

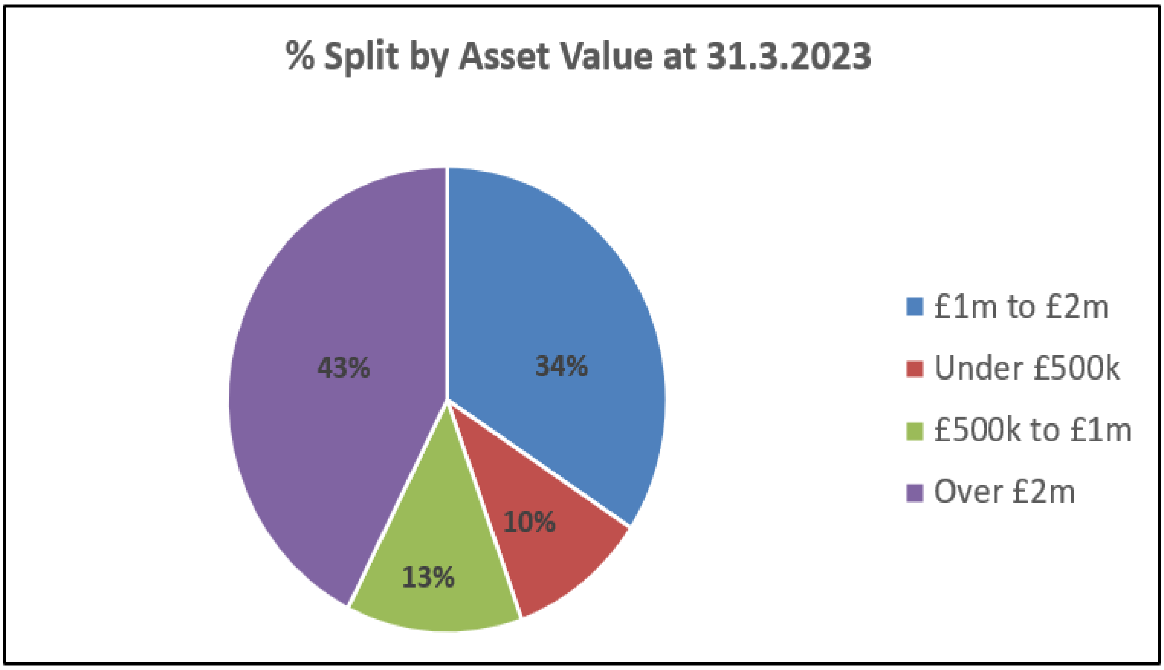
Current Position

4.29 The table below shows the returns being made on previous acquisitions from the Asset Investment Strategy. 2022/23 showed a return of 5.41% compared with 4.85% in 2021/22.

Total Spend £	Gross Return	Investment	2022-23 Actual £	2023-24 £	2024-25 £	2025-26 £	2026-27 £	2027-28 £
1,964,500	3.28%	NCCC Loan (interest)	72,810	67,000	65,900	59,200	59,200	59,200
1,477,500	4.67%	Trent Boulevard (Co-op)	72,540	77,000	77,000	77,000	77,000	77,000
984,000	6.76%	Finch Close	66,504	69,800	74,000	74,000	74,000	74,000
1,917,000	6.26%	Bardon	137,841	128,000	128,000	128,000	128,000	128,000
2,500,000	6.20%	Cotgrave - New Offices	46,564	42,900	44,800	44,800	44,800	44,800
		& Cotgrave- Ind Units	130,387	122,300	125,800	128,000	128,000	128,000
860,000	6.98%	Boundary Court	61,035	63,600	63,600	63,600	65,200	65,200
1,900,000	4.79%	Cotgrave Phase 2	78,633	90,900	92,000	93,200	98,800	98,800
2,450,790	5.59%	Unit 3 Edwalton Business Park	136,850	136,900	136,900	140,800	143,800	143,800
2,083,364	5.28%	Unit 1 Edwalton Business Park	110,000	110,000	110,000	115,500	115,500	115,500
16,137,154	**5.41%**	**Totals**	**913,164**	**908,400**	**918,000**	**924,100**	**934,300**	**934,300**
3,862,846	**RETURNED**							

4.30 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:





4.31 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.

4.32 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, favourably affecting total income. Income has been up across the board including Government Grants, Investment income and recycling credits.

<u>Commercial Investment income and costs</u>

	2022/23 £'000	2022/23 ACTUAL	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000	2027/28 £'000
Commercial Property Income	(1,738)	(1,756)	(1,832)	(1,894)	(1,924)	(1,962)	(1,962)
Running Costs	591	546	480	468	476	482	487
Net Contribution to core functions	(1,147)	(1,210)	(1,352)	(1,426)	(1,448)	(1,480)	(1,475)
Interest from Commercial Loans	(72)	(78)	(67)	(63)	(59)	(59)	(59)
Total Contribution	(1,219)	(1,288)	(1,419)	(1,489)	(1,507)	(1,539)	(1,534)
Sensitivity:							
+/- 10% Commercial Property Income	174	176	183	189	192	196	196
Indicator:							
Investment Income as a % of total Council Income	24.2%	19.9%	18.8%	19.9%	20.3%	20.5%	20.3%
Total Income	7486	9207	10117	9824	9792	9880	9955

The Way Forward

4.33 The Council's original intention was to look at generating around £1m of additional property rental income to help bridge the anticipated budget deficit. 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 2026/27 (see table at paragraph 4.30).

Member and Officer Training

4.34 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 involved in scrutiny and broader training for members who sit on full Council. Previously these needs have been reported through the Member Development Group, with the Council specifically addressing this important issue by:

- Periodically facilitating workshops for members on finance issues most recently provided in January 2023
- Interim reporting and advising members of Treasury issues via Governance Scrutiny Group

With regards to officers:

- Attendance at training events, seminars, and workshops; and
- Support from the Council's treasury management advisors
- Identifying officer training needs on treasury management related issues through the Performance Development and Review appraisal process

CIPFA have developed a self-assessment tool which will need to be completed so that a tailored, recorded and monitored training plan can be drawn up to ensure that training provided achieves the desired outcomes. Attendance at training should be recorded and action taken where poor attendance is identified. Regular communication is encouraged.

The Council has piloted a 'training needs' template which will be modified for new Governance Group Members in the coming months. This should inform training requirements. Furthermore, the Council will continue to have its Annual Treasury Management training session with Councillors provided by its Treasury advisers.

Conclusion

4.35 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 and the future remain uncertain and will be monitored closely. A quarterly update will be presented to this group showing the position for the first quarter of 2023/24.

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 that it is important that it 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 4.27-4.30).

6 Implications

6.1 Financial Implications

Financial implications are covered in the body of the report.

6.2 Legal Implications

This reports 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 2022/23 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 2022/23; Capital and Investment Strategy 2022/23; Treasury Management Update – Mid-Year Report 2022/23 and quarters 1 and 3 Reports 2022/23
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.

SONIA - Sterling Overnight Index Average. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors