Governance Scrutiny Group

Thursday, 30 May 2024

Capital and Investment Strategy Outturn 2023/24

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 2023/24 financial year reporting against the Council's Capital and Investment Strategy 2023/24.

1.2 The report also provides information on the Council's commercial investment activity 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 considers and agrees the 2023/24 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 2023/24. 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).

4 Supporting Information

TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2023/24, 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:

Table 1: Prudential and Treasury Indicators

Prudential and Treasury Indicators	2022/23 Actual £'000	2023/24 Estimate £'000	2023/24 Actual £'000
Capital Expenditure	15,419	9,576	6,752
Capital Financing Requirement	13,266	12,605	9,889
Investments	(59,914)	(48,932)	(71,215)

4.2 The approved capital programme for 2023/24 was £9.576m, with £5.426m brought forward from 2022/23 less other budget adjustments of £2.540m during the year giving a total provision for the year of £12.462m. Actual expenditure against the approved programme was £6.752m giving rise to a variance of £5.710m. Carry forwards of £4.168m have been requested to Cabinet as part of the Final Outturn Report.

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:

Table 2 Capital Expenditure and Financing

Capital Expenditure and Financing	2022/23 Actual £'000	2023/24 Estimate £'000	2023/24 Actual £'000
Capital Expenditure	15,419	9,576	6,752
Less Financed by:			
Capital Receipts	(4,386)	(3,387)	(3,026)
Capital Grants	(2,790)	(3,739)	(3,042)
Reserves	(1,243)	(1,450)	(684)
Increase in borrowing need	7,000	1,000	0

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

2023/24 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 2023/24 represents a key prudential indicator and is shown below. The table shows additional internal borrowing was needed in 2023/24 giving a closing balance of £9.889m after deducting the MRP of £1.255m and £2.122 applied capital receipts and S106 funding in 2023/24.

Table 3 Capital Financing Requirement

Capital Financing Requirement (CFR)	2022/23 Actual £'000	2023/24 Actual £'000
Opening Balance	7,283	13,266
Add: unfinanced capital expenditure	7,000	0
Less MRP/VRP	(1,017)	(1,255)
Less applied Capital Receipts and S106	0	(2,122)
Closing Balance	13,266	9,889

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.

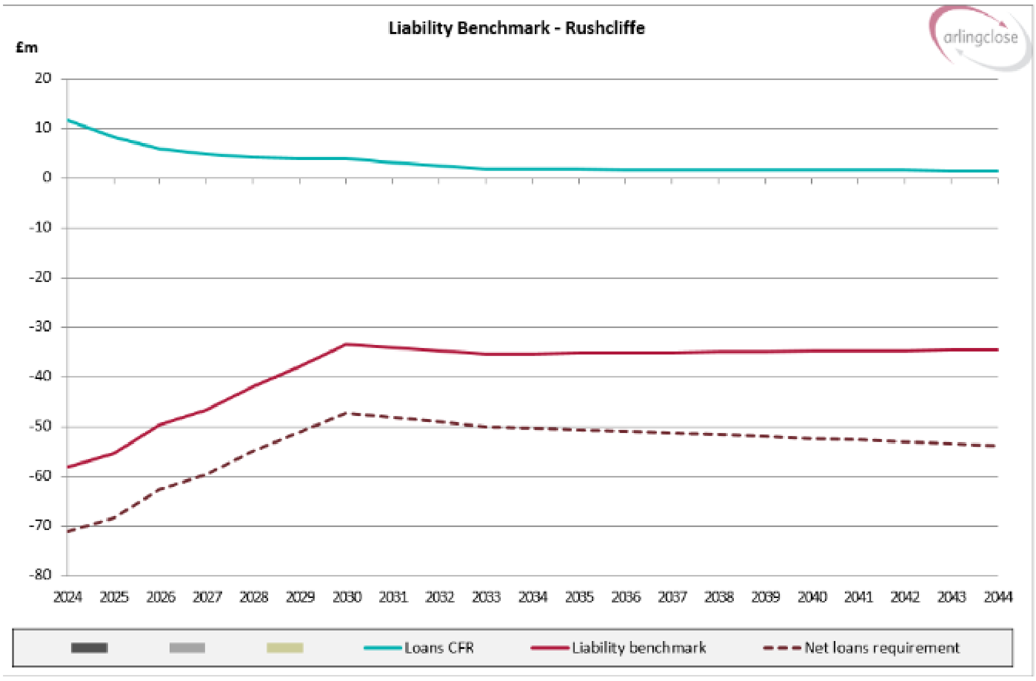
4.12 The authorised limit is the "affordable borrowing limit" required by section 3 (1) of the Local Government Act 2003 and represents the limit beyond which borrowing is prohibited and was set at £25m in the 2023/24 Strategy.

4.13 As the Council had no recourse to borrow externally during 2023/24 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.

4.15 The Liability (or Asset) Benchmark reflects the real need to borrow and is shown graphically (Chart 2). The Council's CFR is reducing due to MRP repayments, reserves are being used to fund future capital expenditure and working capital/S106 monies are returning to a normal level. The Liability Benchmark shows the Council has no need to borrow over the medium term.

Chart 2 Liability Benchmark



The Ratio of Financing Costs to Net Revenue Streams

4.16 This is an indicator of affordability and compares net financing costs (MRP, borrowing costs, 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 higher than budget due to interest rates throughout the year remaining above expectations at the time of budgeting and this exceeding MRP payments and higher cash balances (as can be seen with higher investments in the earlier Table 1).

Table 4 Ratio of Financing Costs to Net Revenue Stream

Ratio of Financing costs to net revenue stream	2022/23 Actual £'000	2023/24 Estimate £'000	2023/24 Actual £'000
Net Financing Costs	-66	-66	-633
Net Revenue Stream	10,544	14,406	15,754
Ratio	-0.63%	-0.46%	-4.02%

4.17 Net income from commercial and service investments is expressed as a percentage of net revenue streams. 2023/24 was slightly lower than estimated due to net revenue streams being higher due to higher than expected specific Grant Income and Business Rates.

Table 5 Net Income to Net Revenue Stream

Net Income to Net Revenue Stream	**2023/24 Estimate £'000**	**2023/24 Actual £'000**
Net Income from commercial and service investments	1,695	1,781
Net Revenue Stream	14,406	15,754
Percentage	11.8%	11.3%

Upper Limits for Fixed and Variable Rate Exposure

4.18 The purpose of these indicators is to allow the Council to manage the extent to which it is exposed to changes in interest rates. Exposure is currently 44% for Fixed Rate and 56% for Variable, both within limit.

Table 6 Upper Limits for Fixed and Variable Rate Exposures

Upper Limits for Fixed and Variable Rate Exposures	**2023/24 Estimate £'000**	**2023/24 Actual £'000**
Fixed Interest Rate limit	50%	44%
Variable Interest Rate limit	100%	56%

Upper Limit for Total Principal Sums invested over 1 year

4.19 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.

Table 7 Upper Limit for Total Principal Sums invested over 1 year

Upper Limit for Total Principal Sums Invested over one year	**2023/24 Estimated £'000**	**2023/24 Actual £'000**
Total Investment balance	48,932	71,215
Limit (50% of total investment)	24,466	35,608
Sums invested over one year	0	0

Treasury Position on 31 March 2024

4.20 The Council's debt and investment position is managed by the Treasury team 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 2023/24.

Table 8 Treasury Position on 31 March 2024

Financial Institution	Amount Invested £	Length of Investment	Interest Rate
Standard Chartered	3,000,000	183 days	5.50%
Standard Chartered	3,000,000	183 days	5.43%
HSBC ESG	5,308,850	Call	5.23%
Rushmoor Borough Council	5,000,000	364 days	4.50%
Moray Council	5,000,000	365 days	5.00%
North Lanarkshire	5,000,000	365 days	5.00%
Central Bedfordshire Council	5,000,000	30 Days	5.52%
Stockport Metro Borough Council	5,000,000	126 Days	5.50%
Aviva Investors	225	Call	5.17%
Blackrock	457,924	Call	5.24%
Ccla - Psdf	139,776	Call	5.26%
Federated Investors (Uk)	5,367,640	Call	5.29%
Goldman Sachs Asset Management	267,480	Call	5.14%
Handelsbanken Plc	12,052	Call	0.25%
Hsbc Asset Management	334,164	Call	0.50%
Invesco Aim	7,643,565	Call	5.26%
Aberdeen Asset Management	1,306,864	Call	5.26%
Bank Of Scotland Plc	892	Call	0.01%
Bank Of Scotland Plc	113,150	32 Days	3.75%
Barclays Bank Plc	6,733	Call	2.00%
Barclays Bank Plc	4,668,026	32 Days	5.20%
Handelsbanken Plc	12,511	35 Days	2.75%
Santander Uk Plc	450,322	Call	3.23%
Santander Uk Plc	86,559	35 Days	4.78%
Royal London Cash Plus Fund	1,005,085	On-going	3.96%
Ccla Property Fund	1,970,157	On-going	4.36%
Ccla Diversified Income Fund	1,929,604	On-going	3.25%
Aegon Diversified Income Fund	4,597,766	On-going	6.80%
Ninety One Diversified Income Fund	4,535,612	On-going	6.20%
Average Interest Rate			5.24%
Total	**71,214,957**		

The Strategy for 2023/24

4.21 The expectation, within the strategy for 2023/24, was that there would be a stepped increase with interest rates peaking at 4.5% in June 2023 before starting to tail off from December 2023 dropping to 4.0% in March 2024. However, in an effort to bring down inflation the Monetary Policy Committee has maintained a regular increase in base rates. At its May meeting interest rates were raised by 0.25% to 4.5% and again by 0.5% to 5% on 22 June. The base rate today currently stands at 5.25% following a vote to raise from 5% on 3 August 2023 and voting to maintain at this level at their remaining meetings in 2023/24. 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. Council's investments were where possible placed in short-term liquid assets to benefit from increasing rates. Generally, short term investment options have returned rates in line with BoE base rate and have at times yielded a better return than longer term investment options. Notwithstanding that, the Council must invest some of its cash longer term so as to spread risk in line with the strategy.

Investment Rates and Outturn Position in 2023/24

4.22 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 5.24% compared with the budgeted rate of 4.50%, and an actual rate of 3.79% in 2022/23. As well as elevated 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 £1,887,600 against a budget of £1,359,300.

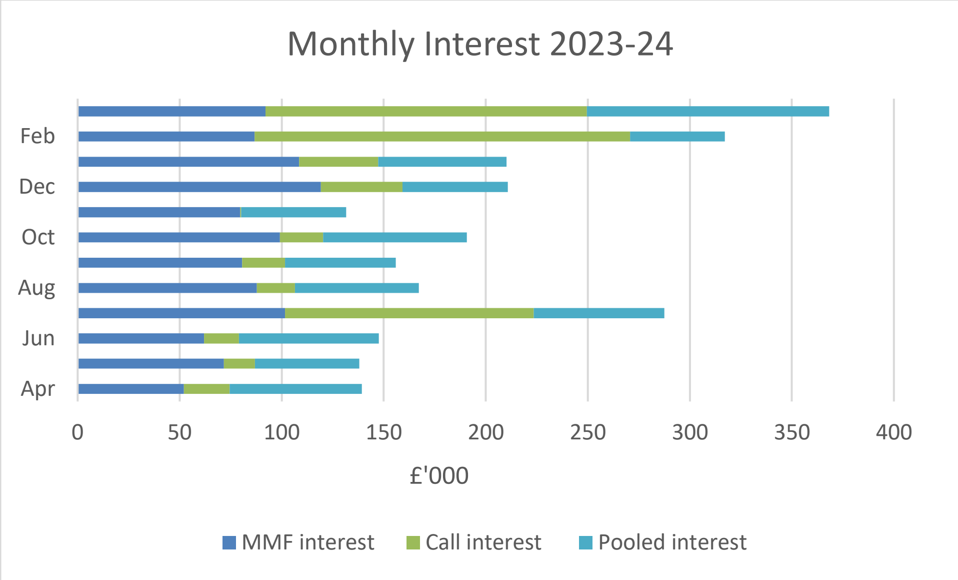
4.23 The fair value of the Council's diversified funds can fluctuate. During the year the value increased by £0.272m. Whilst this is an improvement, the overall difference from the initial investment is £0.961m. To mitigate this loss, appropriations have been made to a reserve and the balance currently stands at £1.173m to cushion any adverse fluctuations. There is currently a statutory override, effective to 31 March 2025, which prevents any accounting loss impacting on the revenue accounts.

Table 9 Fair Value of diversified (pooled) funds at 31.3.24

Fair Value	Amount Invested	31/03/2023	31/03/2024	Difference	Difference in valuation from initial
Aegon	5,000,000	4,364,956	4,597,766	232,810	(402,234)
Ninety One	5,000,000	4,559,707	4,535,612	(24,094)	(464,388)
RLAM	1,000,000	983,676	1,005,085	21,409	5,085
CCLA Property	2,000,000	2,018,374	1,970,157	(48,217)	(29,843)
CCLA BWCF	2,000,000	1,839,164	1,929,604	90,440	(70,396)
Total	15,000,000	13,765,876	14,038,224	272,348	(961,776)

4.24 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. As interest rates have been particularly high in 2023/24, Money Market Funds at 5.06% have returned only marginally less than the diversified funds at 5.45%. It should be noted that the balance invested in Money Markets fluctuates month by month.

Chart 1 -Different investments and respective interest earned



4.25 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 23 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.

4.26 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. The Council continues to face financial challenges and although reserve levels are predicted to decline over the medium term, they are maintained at a healthy level sufficient to support against risk and uncertainties and continue to deliver the capital programme. There has been a net transfer to earmarked reserves of £1.274m. The most significant transfers to reserves were a net £626k to the organisation stabilisation reserve from revenue underspends and £375k to the Investment Property Sinking Fund. The movement from reserves comprises a few balances use of Vehicle Replacement Reserve £300k; release from Collection Fund Reserve £353k. There is an increase in usable capital receipts. These will be used to fund deferred schemes in the capital programme.

Table 10 Balance Sheet Resources

Balance Sheet Resources	Balance at 31/03/2023 £'000	Balance at 31/03/2024 £'000
General Fund Balance	2,604	2,604
Earmarked Reserves	19,673	20,947
Usable Capital Receipts	1,085	3,422
Capital Grants Unapplied	154	98
Total	23,516	27,071

Conclusion – Treasury Management

4.27 Overall, the Council has been successful in achieving its objectives in line with the Strategy of ensuring security of its investments; 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 Council continues to pursue Environmental Social and Governance (ESG) investments where these satisfy the principles of security and liquidity but it is still an emerging market and therefore the risks need to be carefully balanced. Whilst inflation has been on a downward trend during 2023/24, it is still well above the BoE target of 2% and means that there may not be as rapid a decline in interest rates as expected. Coupled with the troubles in the Middle East, and a mild recession in the second half of last year, the economy looks set to remain unstable. We will continue to monitor the position closely.

ASSET INVESTMENT STRATEGY

Overview

4.28 Guidance on Treasury Management activity focuses on the role of longer-term investments specifically held to make a commercial return. The Prudential Code includes the principle that the purchase of commercial property purely for profit cannot lead to an increased capital financing requirement (see paragraph 3.1). The Council no longer invests in property for commercial gain.

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

Investments 2023/24

4.30 2023/24 remained an uncertain year with pending general election, mild recession, elevated inflation and high interest rates all impacting on the economy.

Current Position

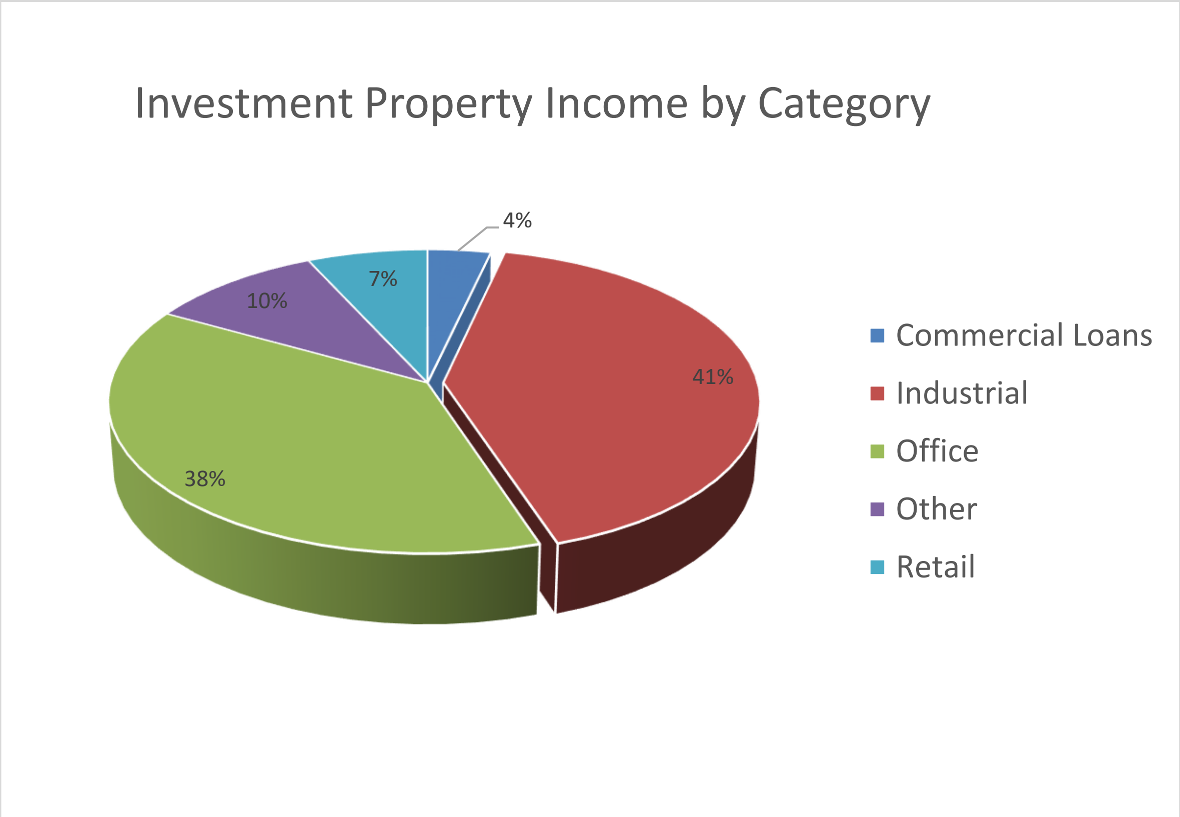
4.31 The table below shows the returns being made on previous acquisitions from the Asset Investment Strategy. 2023/24 showed a return of 5.92% compared with 5.41% in 2022/23.

Table 12 AIS investment returns 2023/24

Investment Value £	Gross Return	Investment	2022/23 Actual £	2023/24 Actual £
1,964,500	3.64%	NCC Loan (interest)	72,810	71,468
1,477,500	5.21%	Trent Boulevard (Co-Op)	72,540	77,021
984,000	7.85%	Finch Close	66,504	77,195
1,917,000	7.41%	Bardon	137,841	142,000
2,500,000	7.09%	Cotgrave Offices	46,564	45,364
		and Cotgrave Industrial Units	130,387	131,934
860,000	6.78%	Boundary Court	61,035	58,300
1,900,000	4.47%	Cotgrave Phase 2	78,633	84,885
2,450,790	5.58%	Unit 3 Edwalton Business Park	136,850	136,850
2,083,364	5.28%	Unit 1 Edwalton Business Park	110,000	110,000
16,137,154	5.92%	Total	913,164	935,017

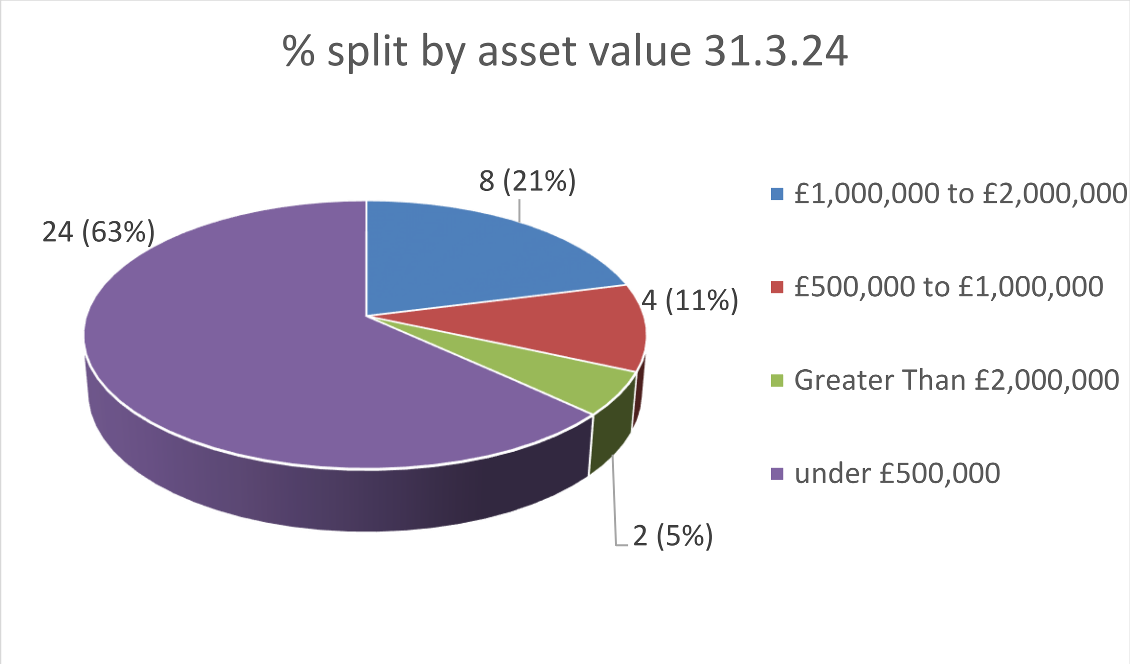
4.32 If we look at the Council's investment property portfolio there is a good spread of risk (classified by the rental earned) as depicted below:

Chart 2 – Investment Property Income by Category



4.33 Chart 3 below shows the Council's overall property portfolio classified by asset value and number of investments

Chart 3 percentage split of overall property portfolio by asset value



4.34 Many of the Council's investments have been in industrial units (given its focus on economic regeneration) and in offices and these have been very successful. Further diversification of investments mitigates the risk of income payment default.

4.35 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 well within this range.

Commercial Investment income and costs

Table 13 Commercial Investment income and costs

Commercial Investments	2023/24 Estimate £'000	2023/24 Actual £'000
Commercial Property Income	(1,832)	(1,918)
Running Costs	480	443
Net contribution to core functions	(1,352)	(1,475)
Interest from Commercial Loans	(67)	(71)
Total Contribution	(1,419)	(1,546)
Total Income	(10,117)	(10,725)
Investment Income as a % of total Council income	18.8%	18.5%
Sensitivity +/- 1% income	(183)	(192)

The Way Forward

4.36 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 with further increases relating only to rent increases rather than in growth of the portfolio from acquisitions.

Member and Officer Training

4.37 The 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 2024
- 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.

4.38 Given the technical nature of the subject failure to attend relevant training sessions undermines the scrutiny process.

4.39 The Council will continue to have its Annual Treasury Management training session with Councillors provided by its Treasury advisers.

Conclusion

4.40 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 2024/25.

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 4.28-4.32).

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.

6.5 Biodiversity Net Gain 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 considers and agrees the 2023/24 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 2023/24; Capital and Investment Strategy 2023/24; Treasury Management Update – Mid-Year Report 2023/24 and quarters 1 and 3 Reports 2023/24
List of appendices (if any):	Appendix 1 - Glossary of Terms

Appendix 1

Glossary of Terms

BoE – Bank of England

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.

ESG – stands for environmental, social, and governance and refers to how companies score on these responsibility metrics. Environmental criteria gauge how a company safeguards the environment. Social criteria examine how it manages relationships with employees, suppliers, customers, and communities. Governance measures a company's leadership, executive pay, audits, internal controls, and shareholder rights.

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

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.

MRP – Minimum Revenue Provision – is the minimum amount which a Council must charge to its revenue budget each year, to set aside a provision for repaying external borrowing. This is an annual revenue expense in a Council's budget.

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.