Governance Scrutiny Group

Thursday, 28 November 2024

Capital and Investment Strategy – Quarter 2 Report 2024/25

Report of the Executive Manager - 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 September 2024.

1.2. The Capital and Investment Strategy for 2024/25, approved by Council on 7 March 2024, 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 Group reviews and comments as necessary on the Capital and Investment Strategy update position as of 30 September 2024.

3. Reasons for Recommendation

3.1. CIPFA's Code of Practice for Treasury Management (2021) recommends that Councillors should be informed of Treasury Management activities quarterly. This report, therefore, ensures this Council is embracing best practice for the scrutiny of capital and investment activity in accordance with the CIPFA Code of Practice.

4. Supporting Information

Economic Forecast

4.1. Inflation (CPI) has continued to decline over the quarter, falling from an annual rate of 2.0% in May to 1.7% in August, in line with the Bank of England's target. However, it is expected to edge up to about 2.5% towards the end of the year before falling again.

4.2. The Bank of England dropped the base rate to 4.75% at its Monetary Policy Committee on the 6th November and further interest rate reductions are expected for this year. The Treasury Management Strategy assumed an interest rate of 4.5% for this year with further cuts next year taking the average rate to

3.3% for 2025/26. Our Treasury Advisors are now forecasting that the rate will drop to 3.75 from December 2025 and remain at this level for a couple of years.

4.3. The UK economy is estimated to have grown 0.5% in Quarter 2 (Apr to June) 2024, and is expected to rise to 1.1% in 2024, with a projection of 1.0% in 2025. The economy is expected to grow by 1.1% in 2026, a minor upward revision but there are still risks to economic growth due to an ageing population, climate change and rising geopolitical tensions.

Investment Income

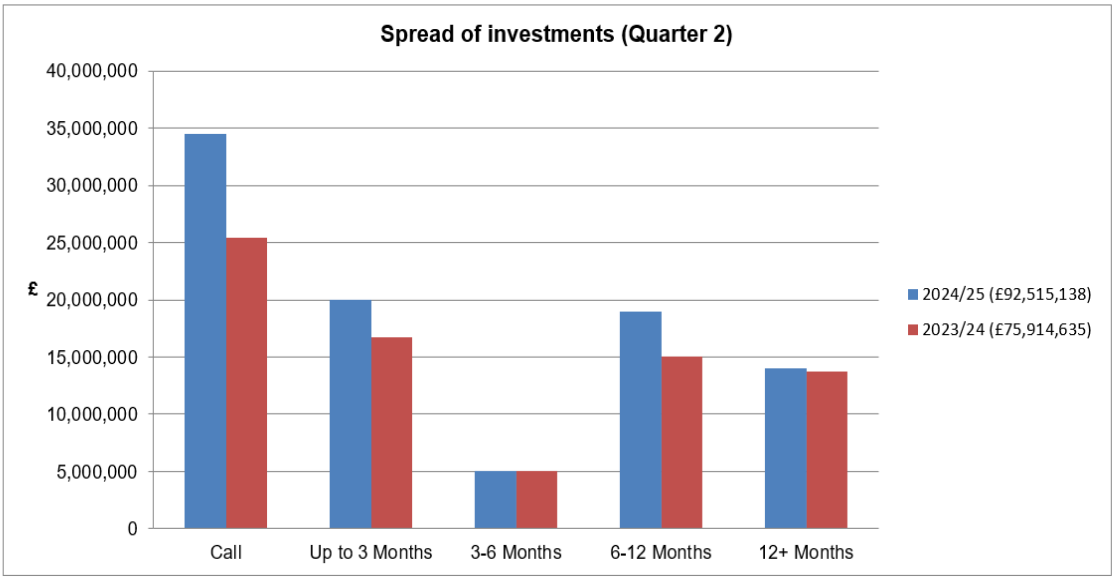
4.4. Based on the Arlingclose interest rate forecast at the time (4.5%), the Council budgeted to receive £1,043,200 in investment income in 2024/25 (compared with £1,359,300 in 2023/24) (net of S106 and CIL interest). Actual interest earned to 30 September 2024 totalled £1,023,633 with total receipts for the year expected to be approximately £1,900,000 (£1,887,576 in 2023/24). Interest receipts are higher than estimated due to investment balances and interest rates both being higher than expected. All investments have been made in accordance with the Council's Capital and Investment Strategy. The Council achieved an average interest rate of 4.88% in quarter 2.

4.5. The average level of funds available for investment purposes during the quarter was £70.07m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants, S106 receipts and progress on the capital programme. The Council holds £14.038m core cash balances for investment purposes (i.e., funds available for more than one year).

4.6. 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. The Council also currently holds two ESG (Environmental, Social and Governance) accounts totalling £7.35m. A full list of investments at 30 September can be found at **Appendix A**. Overall, the rates of return on the Diversified Funds (4.91%) are slightly higher than those achieved on MMFs (4.18%), but interest rates are more volatile on these funds.

4.7. The graph below depicts the Council's investment spread showing the range of investments over different time periods, balancing both cash flow risk and counterparty risk. The spread of investments is comparable to this time last year, although investment balances are higher. To ensure liquidity, the Council continues to hold considerable sums over the short term, with a greater number of institutions, but with interest rates coming down the Council will be looking to invest for slightly longer terms in the future to maximise returns. This is compliant with the Council's Capital and Investment Strategy and recommended action by the Council's Treasury advisors.

Graph 1



4.8. As reported in the Quarter 1 report, the Council is continuing to pursue options for investing in high quality Bonds. These are market tradeable (examples of which are the UK Government) and have low risk of default due to collateral being held by the intermediary and are exempt from bail-in. They provide a regular income stream with reduced capital volatility that might be experienced with other asset classes.

4.9. The Council ensures investments are secure and that liquidity is achieved whilst at the same time it is proactively looking to maximise its rate of return (See paragraph 4.7).

4.10. It has previously been reported that the Council's diversified funds have been subject to fluctuations in fair value. The current position can be seen in **Appendix B**. Funds are still volatile but loss in capital value largely experienced in previous years, is reversing and has been mitigated by appropriations to the Treasury Capital Depreciation Reserve (current balance of £1.173m). The statutory override currently in place, preventing any accounting adjustments impacting on the revenue accounts, is due to end 31st March 2025. The Council will continue to monitor the position on these investments and take advice from the treasury advisors and as appropriate increase or reduce the reserve. Whilst the value of this type of investment can fluctuate, the revenue returns make up a healthy proportion of the overall returns on investment (20% in 2023/24).

Borrowing and Prudential Indicators

4.11. 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 with the approved Capital and Investment Strategy.

4.12. The authorised limit represents the limit beyond which external borrowing is prohibited and is set as part of the Treasury Strategy, whereas the operational boundary is the expected borrowing position of the Council based on the CFR and a buffer. The operational boundary set for the year is £15m (see **Appendix**

C). The authorised limit is set at £20m and any change in this would require Full Council approval.

4.13. Considering cash balances in 4.5, the Council continues to internally borrow to fund capital expenditure and does not envisage externally borrowing during the medium term.

4.14. The Liability (or Asset) Benchmark reflects the real need to borrow (**Table 1**). The Council is reporting a credit balance (asset), which shows that the Council has no need to borrow over the medium term since existing resources exceed the underlying need to borrow. The projected position at the end of the year is better than expected due to S106 balances, which feed into the working capital figure, together with higher usable reserves. Working capital is projected to reduce over the medium term as S106 balances reduces and resources are used to fund the capital programme.

Table 1 – Liability/Asset Benchmark

LIABILITY/(ASSET) BENCHMARK	2024/25	2024/25	2025/26	2026/27	2027/28	2028/29
	£'000	Projection	£'000	£'000	£'000	£'000
Closing CFR	7,863	7,689	6,515	5,776	5,602	5,428
Less:						
Usable Reserves	(22,663)	(32,001)	(26,009)	(20,413)	(18,044)	(16,597)
Working Capital	(40,906)	(64,733)	(48,070)	(46,070)	(44,070)	(42,070)
Plus, minimum investments	10,000	10,000	10,000	10,000	10,000	10,000
LIABILITY/(ASSET) BENCHMARK	(45,706)	(79,045)	(57,564)	(50,707)	(46,512)	(43,239)

Capital Expenditure and Financing

4.15. 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 C** and key comments to note regarding Capital are mentioned below.

4.16. The original Capital Programme for 2024/25 was £11.079m, with £3.405m carry forwards and other adjustments of £2.407m, and slippage of £3.756m giving a current budget of £13.135m. The projected outturn is £9.537m, resulting in an estimated underspend of £3.598m arising from the need to reprofile the provision for Cotgrave/Keyworth Leisure Centres, the Acquisition of Traveller Site (further recommendations to repatriate this are included in the report to Cabinet in December) and post-opening enhancements at Bingham Arena and the Crematorium not being committed.

4.17. The actual capital expenditure forms one of the required prudential indicators. **Table 2** below shows the actual capital expenditure and how this is financed, fully funded from council resources.

Table 2 Capital Expenditure and Financing

Capital Programme	2023/24 Actual £'000	2024/25 Estimate £'000	2024/25 Projection £'000
Capital Expenditure	6,752	13,135	9,537
Less Financed by:			
Capital Receipts	(3,026)	(4,333)	(2,204)
Capital Grants	(3,042)	(6,367)	(6,029)
Reserves	(684)	(2,435)	(1,304)
Increase in borrowing need	0	0	0

4.18. 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 2024/25 and prior years that has not yet been paid for by revenue or other resources. No external borrowing was undertaken during the quarter ended 30 September 2024 and the Council does not anticipate a need to externally borrow over the Medium-Term, so the CFR balance continues to reduce after deducting MRP repayments and capital receipts as seen in **Table 3.**

4.19. The CFR will be adjusted by the impact of the implementation of IFRS16 (the impact of all leases going on balance sheet) and this will be updated in the quarter 3 report.

Table 3 Capital Financing Requirement (CFR)

Capital Financing Requirement (CFR)	2023/24 Actual £'000	2024/25 Projection £'000
Opening Balance	13,266	9,889
Add: unfinanced capital expenditure	0	0
Less MRP/VRP	(1,255)	(1,200)
Less applied Capital Receipts and S106	(2,122)	(1,000)
Closing Balance	9,889	7,689

Treasury Management and Prudential Indicators

4.20. During the quarter ended 30 September 2024, the Council has operated within treasury management indicators set and it is not envisaged that there will be any difficulties in the current or future years in complying with these indicators (**Appendix C**).

4.21. All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

4.22. The Expected Investment position is expected to be higher due to rephasing of the capital programme and additional S106 monies.

4.23. Net Income from Commercial and Service Investments to Net Revenue Streams reflects the Council's dependence on investments. The projected figure is marginally lower due to a slightly higher surplus from the business rates pool.

4.24. The ratio of Financing Costs to Net Revenue Streams is a Key Prudential 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 the proportion of net income that is used to pay for financing costs. The projected actual at quarter 2 is -4.30%, the minus indicating that interest receipts exceed financing costs and net revenue streams are slightly higher as mentioned in the paragraph above.

Commercial Investments

4.25. The Council must disclose its dependence on commercial income and the contribution non-core investments make towards core functions.

4.26. The projected position for total contribution of non-core investments towards core functions is 12.7% compared with the estimated figure of 13.4% reflecting rent increases, offset by inflationary increases on service maintenance contracts and legal costs in connection with the disposal of Candleby Lane. The most significant factor however has been the increase in Total Income due to interest receipts as discussed on paragraph 4.4 above (see **Table 4** below).

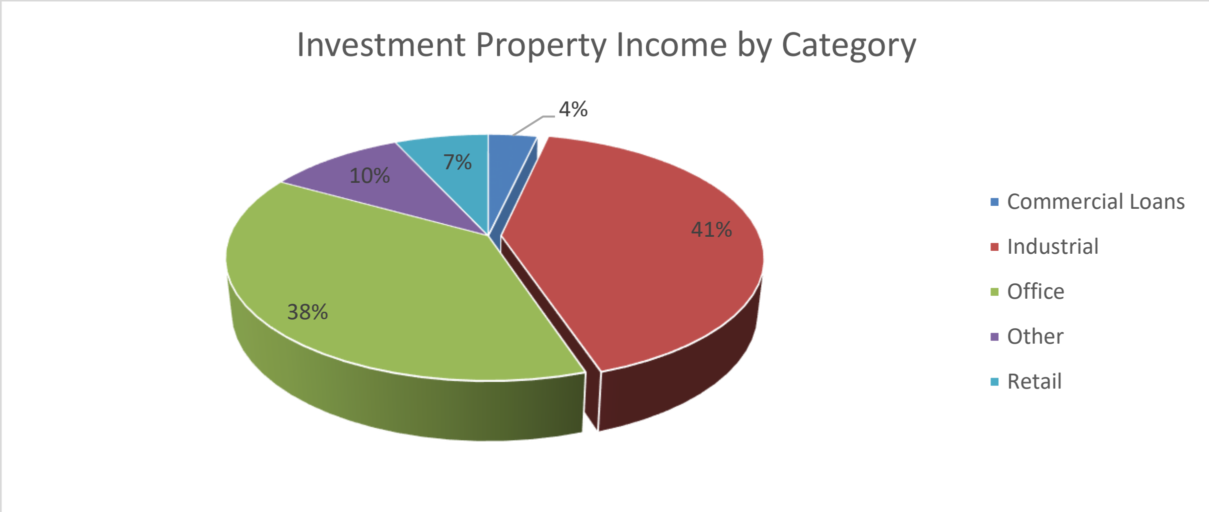
Table 4

Commercial Investments 2024/25	Current Estimate £'000	Actual YTD £'000	Projection £'000
Commercial Property Income	(1,902)	(976)	(1,955)
Running Costs	458	115	477
Net contribution to core functions	**(1,444)**	**(861)**	**(1,478)**
Interest from Commercial Loans	(63)	(33)	(66)
Total Contribution	**(1,507)**	**(894)**	**(1,544)**
Total Income	**(11,231)**	**(7,497)**	**(12,130)**
Total Contribution/Total income	**13.4%**	**11.9%**	**12.7%**
Sensitivity +/- 10%	(190)	(98)	(196)

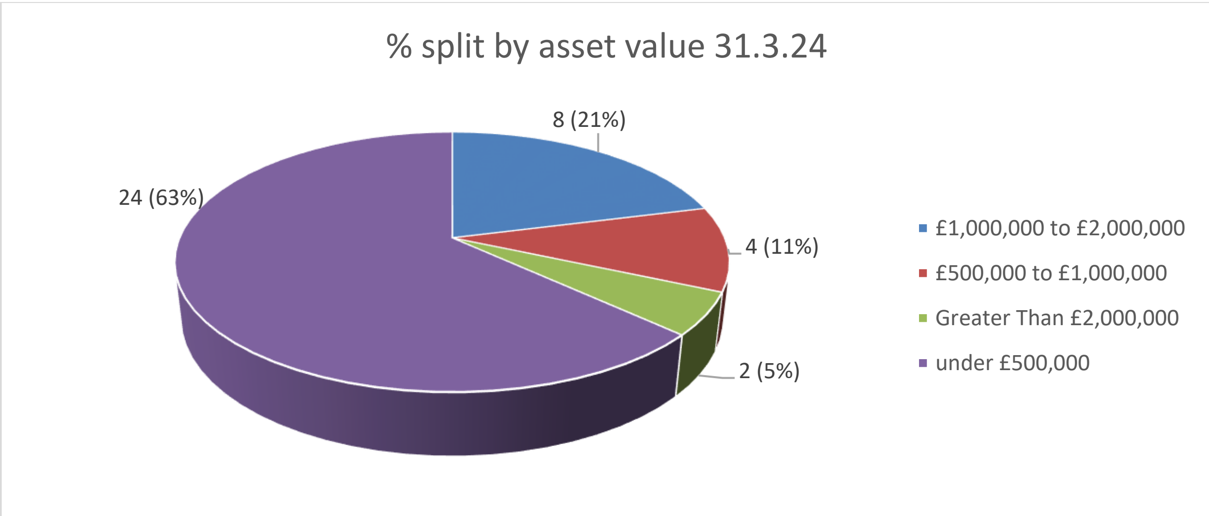
Risk Exposure Indicators

4.27. 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 investments across sectors (graph 2) and the value of these assets (graph 3) can be seen below. Industrial units and office accommodation account for the majority of income from investment properties (79% in total) and coincidently account for 78% of asset value (34% and 44% respectively).

Graph 2



Graph 3



Security and Liquidity

4.28. 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 five-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.

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

4.30. 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 22 February 2024 with the next review planned for spring 2026.

4.31. 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

4.32. The last presentation and training session to Councillors, provided by the Council's Treasury Management Advisors, was 23 January 2024. The next scheduled training session will be held on 17 December 2024.

5. Conclusion

5.1. Officers can confirm that the approved limits within the Capital and Investment Strategy were not breached during the quarter ended 30 September 2024.

5.2. Treasury Management continues to be challenging. The UK economy is recovering but risk remains globally along with inflationary pressures and falling interest rates the US presidential elections and ongoing international conflict which could give rise to further international economic instability. This may have a negative effect on returns that can be achieved from investments, and may impact on the capital value of some of the Council's investments. Officers will continue to monitor the environment 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

None.

7.5. Biodiversity Net Gain Implications

There are no Biodiversity Net Gain Implications as a result of the recommendations in this report.

8. Link to Corporate Priorities

The Environment	Helping to protect the environment by consideration of carbon footprint and fossil-based investments as part of the Capital and Investment Strategy
Quality of Life	No direct impact on quality of life
Efficient Services	Responsible income generation and maximising returns
Sustainable Growth	No direct impact on sustainable growth

9. Recommendations

It is recommended that the Group reviews and comments as necessary on the Capital and Investment Strategy update position as of 30 September 2024.

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Background papers available for inspection	Capital and Investment Strategy 2024/25
List of Appendices:	Appendix A – Investments at 30 Sept 2024 Appendix B – Pooled Funds Appendix C – Prudential and Treasury Indicators for 2024/25 at 30 Sept 2024 –Glossary of Terms

APPENDIX A

Investment Balances as at 30 September 2024

Fixed	Financial Institution	Amount £	Length of Investment	Interest
Pooled Fund	Royal London Cash Plus Fund	1,005,085	On-going	3.96%
Pooled Fund	CCLA Property Fund	1,970,157	On-going	4.36%
Pooled Fund	CCLA Better World Cautious Fund	1,929,604	On-going	3.25%
Pooled Fund	Aegon Diversified Income fund	4,597,766	On-going	6.80%
Pooled Fund	Ninety One Diversified Income Fund	4,535,612	On-going	6.20%
MMF	Aviva Investors1	230	Call	4.91%
MMF	Blackrock 1	334,293	Call	4.97%
MMF	CCLA - PSDF1	3,647,869	Call	4.99%
MMF	Federated Investors (UK)1	9,500,307	Call	5.02%
MMF	Goldman Sachs Asset Management1	1,631,282	Call	4.92%
MMF	HSBC Asset Management ESG1	5,424,530	Call	5.00%
MMF	HSBC Asset Management Business Deposit	1,074,053	Call	2.00%
MMF	Invesco AIM 1	2,508,699	Call	5.01%
MMF	Aberdeen Asset Management1	9,892,998	Call	5.00%
Government	Rushmoor Borough Council	5,000,000	364 days	5.25%
Government	Blackpool Council	5,000,000	91 days	4.90%
Government	Blackpool Council	4,000,000	243 days	4.77%
Government	Harlow Council	5,000,000	184 days	4.80%
Government	LB of Waltham Forest	5,000,000	277 days	4.90%
Government	Surrey County Council	5,000,000	274 days	4.90%
Government	Central Bedfordshire Council	5,000,000	92 days	4.90%
Government	Stockport Metro Borough Council	5,000,000	202 days	5.50%
Banks Unsecured	Bank of Scotland PLC1	862	Call	0.01%
Banks Unsecured	Bank of Scotland PLC32	114,964	32 Days	3.50%
Banks Unsecured	Barclays Bank PLC1	6,766	Call	2.00%
Banks Unsecured	Barclays Bank PLC32	4,770,666	32 Days	4.95%
Banks Unsecured	Handlesbanken PLC1	12,059	Call	0.00%
Banks Unsecured	Handlesbanken PLC35	12,597	35 Days	2.50%
Banks Unsecured	Santander UK PLC1	456,453	Call	2.98%
Banks Unsecured	Santander UK 35	87,950	35 Days	4.53%
	Average Interest Rate			**4.88%**
	Total	**92,514,802**		

APPENDIX B

Pooled Funds as at 30 September 2024

Amount Invested	Fair Value	31.03.24	30.09.24	Difference	Difference in valuation from initial investment
5,000,000	Aegon-Previously Kames	4,597,766.02	4,726,040	128,274	(273,960)
5,000,000	Ninety One-Previously Investec	4,535,612.29	4,601,011	65,399	(398,989)
1,000,000	RLAM	1,005,084.78	1,013,358	8,273	13,358
2,000,000	CCLA Property	1,970,157.29	1,963,153	(7,004)	(36,847)
2,000,000	CCLA BWCF	1,929,603.88	1,926,998	(2,606)	(73,002)
15,000,000		**14,038,224.26**	**14,230,560**	**192,336**	**(769,440)**

APPENDIX C

Prudential and Treasury Indicators

Prudential & Treasury Indicators at 30th September 2024	2024/25 Original Estimate £'000	2024/25 Projected £'000
Prudential Indicators		
Capital Expenditure	16,720	9,537
Expected Investment Position at 31 March 2025	55,706	83,582
Capital Financing requirement at 31 March 2025	7,863	7,689
Ratio of financing costs to net revenue streams	0.88%	-4.30%
Gross Debt (Debt incl PFI & Leases)	0	0
Net Income (from Commercial and Service Investments) to Net Revenue Streams	11.2%	11.1%
Treasury Management Indicators		
Authorised Limit for external debt (Borrowing and other LT Liabs)	20,000	20,000
Operational Boundary for external debt (borrowing and other LT Liabs)	15,000	15,000
Upper limit for fixed interest rate exposure on investments up to 1 year	50%	42%
Upper limit for variable rate exposure (investments)	100%	58%
Upper limit for total principal sums invested over 1 year	27,900	41,791
Liability Benchmark	(45,706)	(79,045)

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 is 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

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.

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 borrowing. This is an annual revenue expense in a Council’s budget.