Corporate Governance Group

Thursday 29 November 2018

Capital and Investment Strategy – Mid-Year Report 2018/19

Report of the Executive Manager - Finance and Corporate Services

1. Summary

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 2018.

1.2. The Capital and Investment Strategy for 2018/19, approved by Council on 1 March 2018 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 which 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 Members note the Capital and Investment Management update position at 30 September 2018.

3. Reasons for Recommendation

3.1 CIPFA's Code of Practice for Treasury Management (2017) recommends that Members should be informed of Treasury Management activities at least twice a year. This report therefore ensures this Council is embracing best practice for the scrutiny of capital and investment activity in accordance with the Code of Practice.

4. Supporting Information

Economic Background

4.1. In the first six months of 2018/19:

- Growth in the UK economy has increased 1%, in line with market expectations
- The Bank of England base rate was raised from 0.5% to 0.75% in August 2018.

Economic Forecast

4.2. Economic growth is projected to remain modest at 1.4% in 2018 and 1.3% in 2019, owing to high uncertainties about the outcome of Brexit negotiations. There is little slack in the economy following years of strong growth, and unemployment is projected to remain below 5%.

4.3. The Bank of England base rate informs the rates that can be obtained from investments. On 2nd August 2018 the Monetary Policy Committee increased the Bank rate by 0.25% to 0.75%. Arlingclose (the Council's Treasury Management advisors) expect the Bank rate to increase to 1.25% over the coming year, but point out that negotiations on exiting the EU continues to cast a shadow over monetary policy decisions.

4.4. Inflation is expected to remain at around 2.5% for the foreseeable future with some monthly volatility.

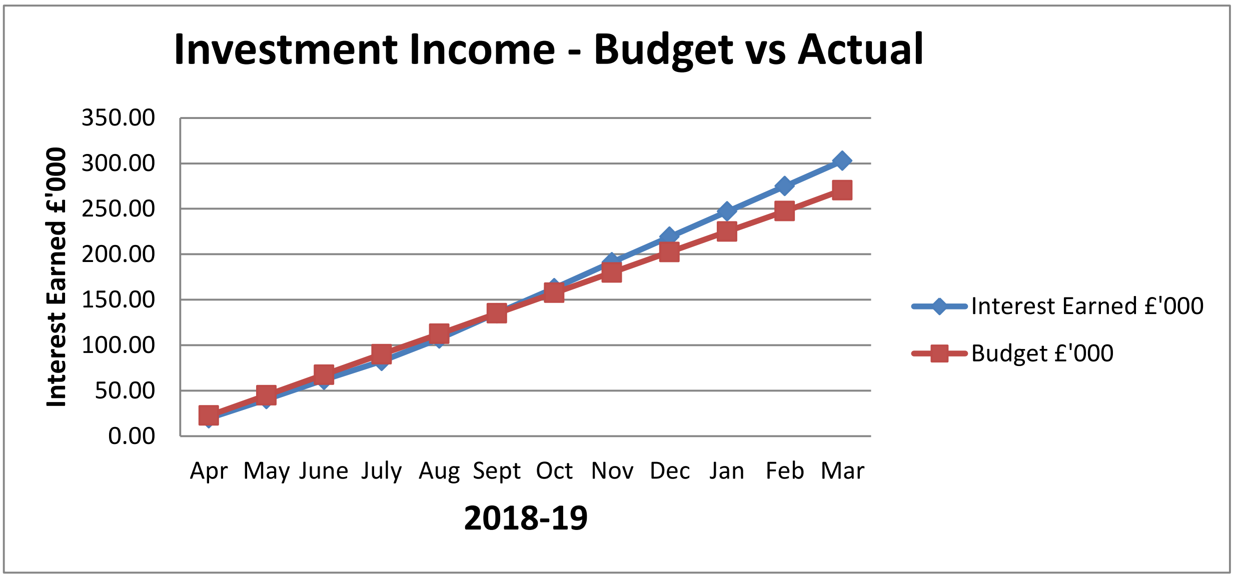
4.5. The economic growth consequences of BREXIT remain speculative, uncertainty over the UK's future trade relations with the EU and the rest of the world will impact on economic growth during the second half of 2018 and in 2019.

Investment Income

4.6. A combination of base rate forecasts, constraints on the lending list and the expenditure expected to be incurred on the Capital Programme meant the Council budgeted to receive £270,500 in investment income in 2018/19. Actual interest earned to 30 September 2018 totalled £137,300 with total receipts for the year expected to be £315,500. Interest receipts are higher than estimated due to higher interest rates and delays in the capital programme. Going forward this could change, for example if interest rates alter or there is any unexpected property investment. All investments have been made in accordance with the Council's Treasury Management Strategy.

4.7. 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, Call Accounts, CCLA Property Fund, UK Local Authorities, Pooled Funds and Temporary Investments with a maximum of £5 million being placed with any single institution.

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



4.9. The average interest rates achieved so far this year on the Council's investments are compared to the London inter bank bid rate (LIBID) rates. Overall rates achieved shows the Council achieved 0.51% against an average LIBID rate of 0.67%.

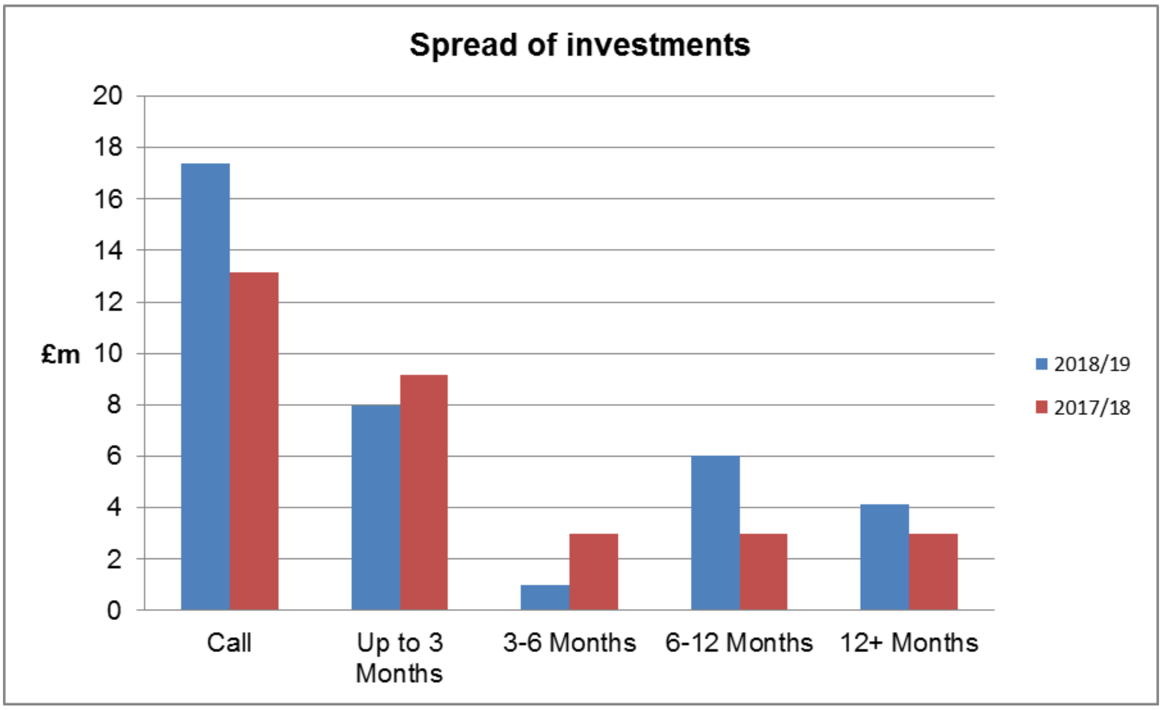
4.10. The table below highlights the level of investment activity and the rates obtained at 30 September 2018. Investments are made in line with Arlingclose's approved counterparty list.

Date	**Financial Institution**	**Amount £**	**Length of Investment**	**Interest Rate**
22 August 2018	Other LA -Blackpool	£5,000,000	365 days	0.70%
28 August 2018	Other LA -Broxtowe	£1,000,000	365 days	0.75%
N/A	Santander	£821,361	60 day notice	0.35%
N/A	Handelsbanken	£875,353	35 day notice	0.35%
N/A	Barclays	£2,474,580	32 day notice	0.52%
N/A	Bank of Scotland	£2,400,317	32 day notice	0.57%
N/A	Santander	£1,379,691	31 day notice	0.30%
N/A	National Counties	£1,000,000	98 day notice	0.82%
N/A	Invesco	£3,457,049	Call	0.66%
N/A	Aberdeen Asset Management	£3,480,506	Call	0.67%
N/A	Federated	£3,633,561	Call	0.7%
N/A	Blackrock	£3,513,770	Call	0.67%
N/A	HSBC	£113,508	Call	0.38%
N/A	CCLA	£931,993	Call	0.69%
N/A	Goldman Sachs	£2,246,981	Call	0.64%
N/A	Residual MMF/Call Account balances	£7,270	Call	0.29%
N/A	CCLA Property Fund	£3,114,599	Ongoing	4.58%
N/A	Royal London Cash Plus Fund	£1,005,605	Ongoing	0.43%
	Total Investments/ Average Interest Rate	**£36,456,143**		**0.92%**

4.11. As the table above indicates, investments at 30 September 2018 totalled £36.45 million with an average rate of interest of 0.92% (2017/18 0.59%). Over the first half of 2018/19 interest rates achieved are better than last year. These funds were available on a temporary basis, and the level of funds available was mainly dependant on the timing of precept payments, receipt of grant and progress on the capital programme. The rates achieved vary between different institutions, for different durations, dependant on when the investment was made.

4.12. It should be noted that £13.5 million of the above investments relate to funds held in relation to Section 106 Agreements that are yet to be released by the Authority. As part of the agreement interest has to be paid over once funds are released. This interest amounts to approximately £55,200.

4.13. The above details the Counterparties that the Council had placed investments with at 30 September 2018. The following graph depicts our investment spread showing the range of investments and the different time periods; balancing both cash flow risk and counterparty risk and shows the movement from longer term to shorter term investments between 2017/18 and 2018/19. A consequence of bail-in is that increasingly the Council is holding lower values of investments, over a shorter period of time, with a greater number of institutions. This is compliant with the Council's Treasury Management Strategy and recommended action by the Council's Treasury advisors.



Borrowing

4.14. 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 Treasury Management Strategy Statement.

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

4.16. No external borrowing is proposed to be undertaken in 2018/19 hence the Authorised Limit and Operational Boundary remain unchanged (see **Appendix A**).

4.17. As part of the Treasury Management 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 in **Appendix A**. Key comments to note are as follows:

(a) Capital Expenditure – The original budget for 2018-19 was £11.906m plus carry forwards of £12m and further adjustments of £0.7m giving a current budget of £24.699m. The projected outturn is £12.633m – estimated underspends of £12.066m.
(b) Financing costs to net revenue stream – higher investment returns more than offset by increase in net service expenditure hence the improved position.
(c) Expected investment position – linked to the underspend on the capital programme- see (a) above.
(d) Capital Financing Requirement – the opening position will increase due to internal borrowing associated with Cotgrave and AIS commitments giving an end of year position of £14.653m.

Commercial Investments

4.18. The definition of investments in CIPFA’s definition of treasury management activities above covers all financial assets of the organisation as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework, which is outlined in the Capital and Investment Strategy.

4.19. The Council is committed to becoming self-sustainable as Central Government funding reduces. This includes ensuring that the Council maximises any income from existing assets and, where there is a business case, invests in assets where there is a commercial return. The Council is holding significant capital funding resources which do not require the authority to undertake borrowing at this stage. These are invested with various financial institutions as detailed above. However, other investments represent an opportunity to generate higher returns on these funds.

4.20. In recent years the Council identified specific sums for its Asset Investment Strategy within the Capital Programme which has totalled £20m. This includes commercial investment in areas such as investment in property and subsidiaries, or loans that support service outcomes.

4.21. Individual commercial investment proposals included within the Asset Investment Strategy are subject to specific business appraisals. The governance surrounding such decisions is included in the AIS.

4.22. The Government issued revised guidance on Local Government Investments, effective from April 2018. This guidance introduces additional disclosure requirements some of which are specific to investments of a commercial nature. The Authority now has to disclosure its dependence on commercial income and the contribution non-core investments make towards core functions. This covers items included in the Council's Asset Investment Strategy, as well as pre-existing commercial investments.

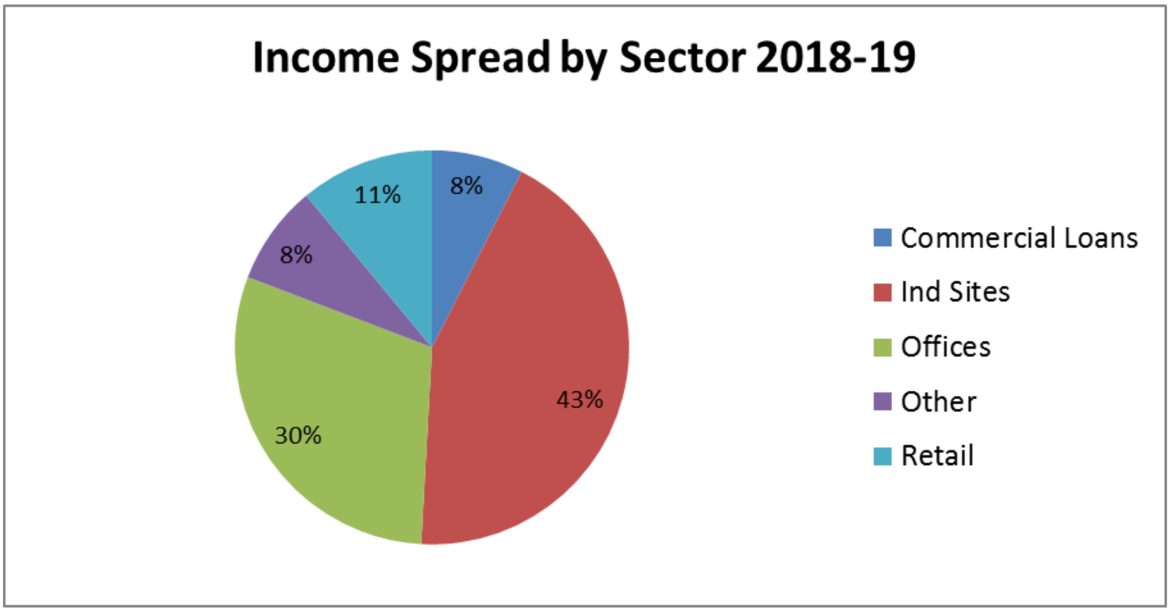
4.23. The expected contributions from commercial investments included in the Asset Investment Strategy are shown below. It should be noted that one investment did not go ahead but was included in the original estimate. In order to manage the risk to the Council's budget, income from commercial investments should not be a significant proportion of the Council's income. As shown below it is estimated to be around 18% in the current year. The Councils objective is that this ratio should not exceed 30% in future years, subject to annual review.

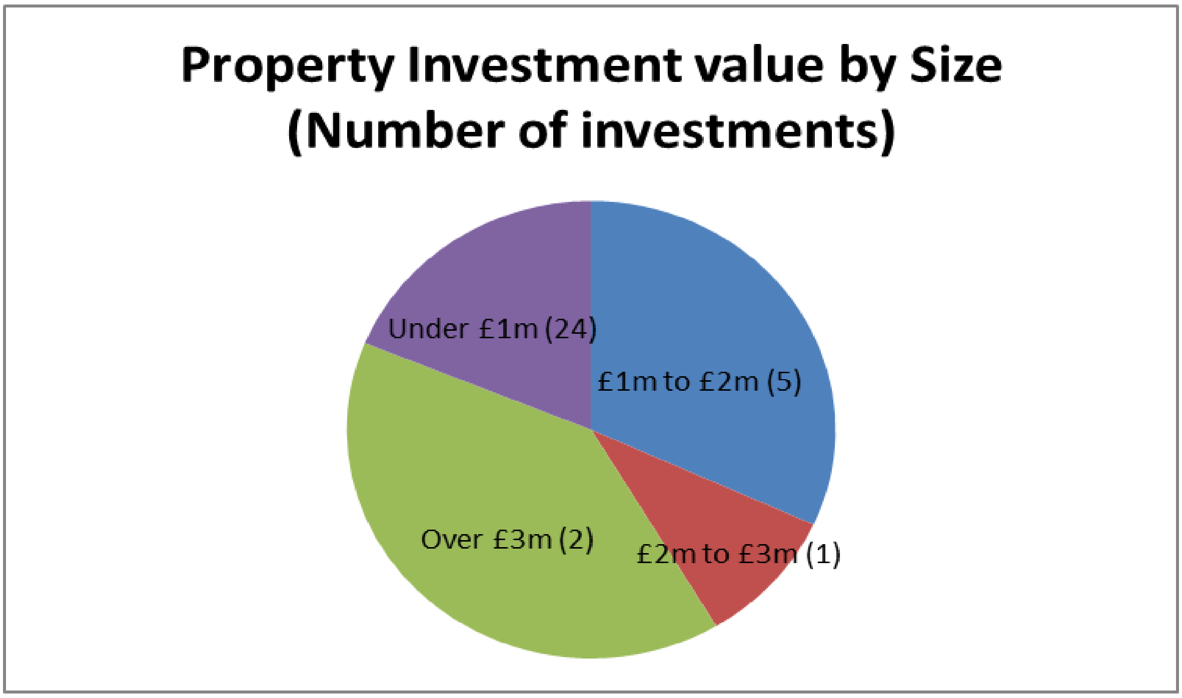
Commercial Investment income and costs

2018/19	**Original £000**	**Current £000**	**Actual £000**	**Projected £000**
Commercial Property Income	(1,464)	(1,292)	(877)	(1,322)
Running Costs	356	274	55	428
Net Contribution to core functions	(1,108)	(1,018)	(822)	(894)
Interest from Commercial Loans	(108)	(108)	(54)	(108)
Total Contribution	(1,216)	(1,126)	(876)	(1,002)
Sensitivity:				
+/- 10% Commercial Property Income	146	129	88	132
Indicator:				
Investment Income as a % of total Council Income	20.1%	17.9%	17.3%	18.0%

Risk Exposure Indicators

4.24. 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.





Security and Liquidity

4.25. 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.

4.26. 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.

4.27. 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.

4.28. 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.

5 Conclusion

5.1. Treasury Management continues to be fraught with difficulty. The UK economy is more uncertain while the terms of BREXIT are being negotiated. Together with general international political uncertainty the effects are expected to have a long term impact on interest rates and the returns that can be achieved from investments. Officers will continue to be vigilant and report any significant issues to the Corporate Governance Group.

5.2. Members should also be aware of recent changes to the CIPFA Code of Practice on both Capital and Treasury Management. A revised Strategy will be reported to the CGG and Full Council as part of the budget setting process in 2019.

6 Other Options Considered

6.1. There are no other options.

7 Risk and Uncertainties

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

8 Implications

8.1. Finance

Financial implications are covered in the body of the report.

8.2. Legal

None.

8.3. Corporate Priorities

Efficient treasury management enables the Council to achieve its corporate priorities.

8.4 Other Implications

None.

9 Recommendations

It is recommended that Members note the Capital and Investment Management update position at 30 September 2018.

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Background papers available for inspection	Treasury Management Strategy 2018/19
List of Appendices (if any):	Appendix A – Prudential and Treasury Indicators for 2018/19 position at 30 September 2018

APPENDIX A

Prudential and Treasury Indicators for 2018/19
Position at 30 September 2018

	2018/19 £'000 Original Estimate	2018/19 £'000 Projected Outturn
Prudential Indicators		
Capital Expenditure	11,906	12,633
Proportion of financing costs to net revenue streams	(2.59%)	(2.72%)
Expected Investment Position	13,635	23,813
Capital Financing requirement as at 31 March 2018	9,300	11,324
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	0	0
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	14200	14200

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