Rushcliffe Borough Council

Governance Scrutiny Group

3 December 2019

Treasury Management – Mid-Year Report 2019/20

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 2019.

1.2. The Capital and Investment Strategy for 2019/20, approved by Council on 7 March 2019 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 2019.

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 2019/20:

- Growth in the UK economy has increased 1.2%, below market expectations
- The Bank of England base rate remains at 0.75%.

Economic Forecast

4.2. Economic growth contracted by 0.2% for quarter 2 and expanded 1.2% year-on-year. Both the quarterly and year-on-year figures were below expectations, estimated at 0% and 1.4% respectively. Growth for the following year is projected to fall slightly to 1.1%. There remain high uncertainties about the outcome of Brexit negotiations and the forthcoming General Election.

4.3. Unemployment remains low at 3.8% and is projected to reach 4.1% during 2020.

4.4. The current Bank of England base rate remains 0.75% and has been since 2 August 2018. The Bank of England says that it's closely watching the British economy to see how it responds to Brexit. Arlingclose (the Council's former Treasury Management advisors, see paragraph 4.31) forecast the rate to remain the same for the foreseeable future, but point out that rates are dependent on Brexit outcomes and the evolution of the global economy.

4.5. Inflation remains around target, albeit displaying a surprising decline in August 2019 to 1.7%, down from 2% in July 2019. Inflation levels are expected to increase to 2.01% in 2020.

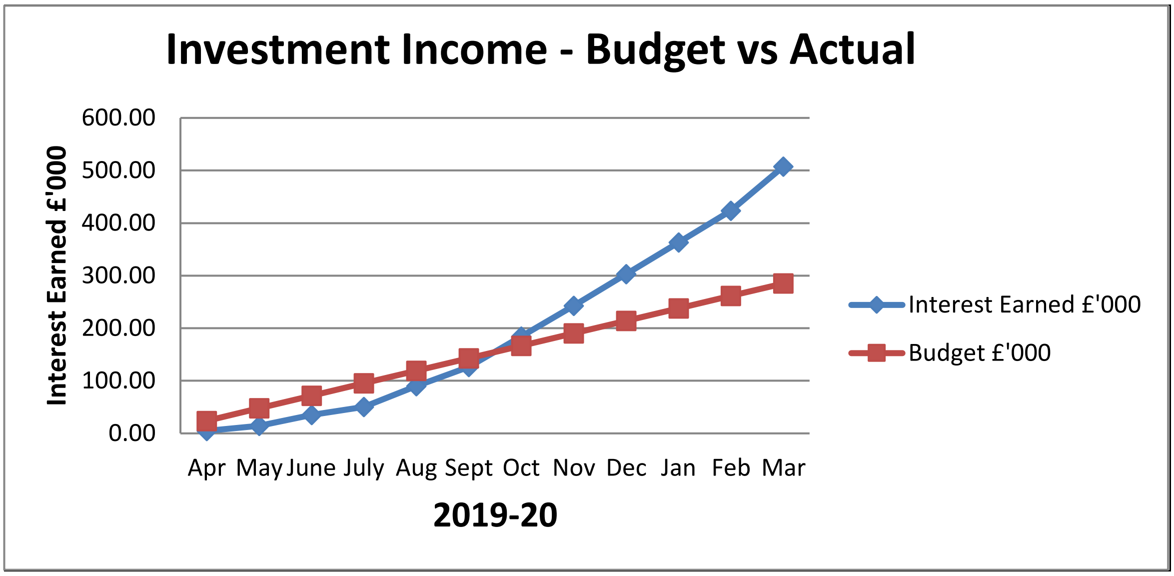
4.6. The economic growth consequences of BREXIT remain speculative, uncertainty over the UK's future trade relations with the EU and the rest of the world will impact on economic growth during the second half of 2019 and in 2020.

Investment Income

4.7. 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 £285,000 in investment income in 2019/20. Actual interest earned to 30 September 2019 totalled £129,050 with total receipts for the year expected to be £483,000. Interest receipts are higher than estimated due to investing in higher interest earning diversified funds coupled with 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.

4.8. 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 and Diversified Funds with a maximum of £5 million being placed with any single institution.

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



4.10. The average interest rates achieved so far this year on the Council's investments are compared to the London interbank bid rate (LIBID) rates. In addition the Council has just over £13 million invested in diversified income and property accounts that are earning on average a rate of 4.3% in interest.

Benchmark	2019-20 LIBID	Council Performance
Instant Access	0.54%	0.68%
1 month	0.59%	0.75%
3 month	0.63%	-
6 month	0.70%	-
12 month	0.76%	0.88%

4.11. The table below highlights the level of investment activity and the rates obtained at 30 September 2019. Investments were made in line with Arlingclose's approved counterparty list.

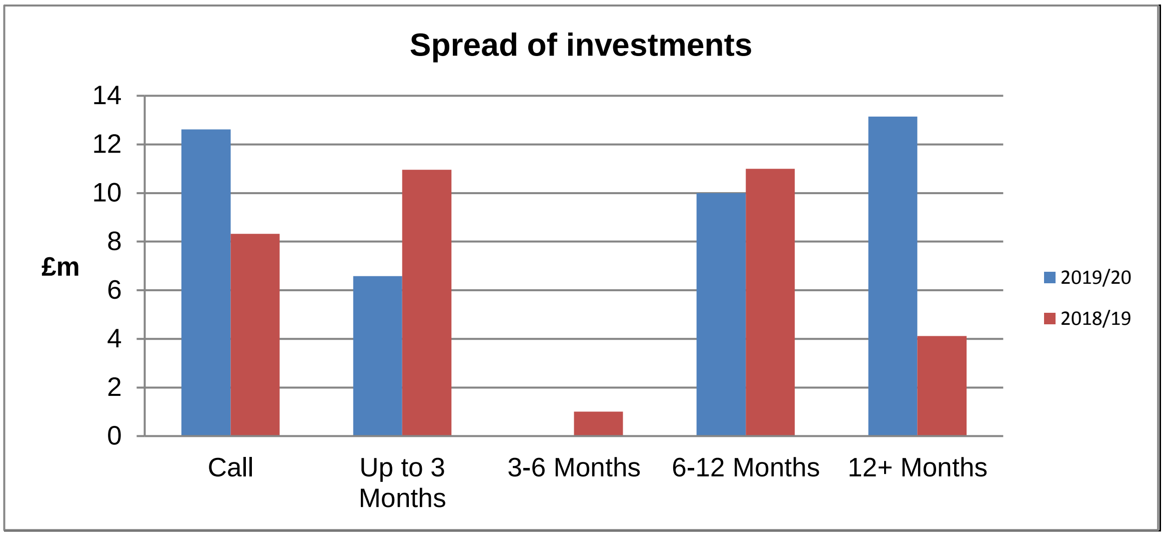
Financial Institution	Amount £	Length of Investment	Interest	Date
OLA - Cambridgeshire CC	5,000,000	12 Months	0.80%	30 Aug 2019
OLA - Guildford Borough Council	5,000,000	12 Months	0.95%	22 May 2019
Blackrock	1,520,970	Call	0.68%	N/A
Federated	4,436,417	Call	0.73%	N/A
HSBC	1,285,413	Call	0.38%	N/A
Invesco	1,154,052	Call	0.71%	N/A
Aberdeen Asset Management	4,065,302	Call	0.73%	N/A
Barclays	4,253,910	32 Days	0.75%	N/A
Santander	2,216,235	35 Days	0.75%	N/A
Residual MMF/Call Account balances	259,225	Call	0.37%	N/A
Royal London Cash Plus Fund	1,002,657	On-going	1.38%	N/A
CCLA Property Fund	2,147,456	On-going	4.58%	N/A
CCLA Diversified Income Fund	1,994,926	On-going	4.58%	N/A
Kames Diversified Income Fund	4,000,000	On-going	5.01%	N/A
Investec Diversified Income Fund	4,000,000	On-going	4.07%	N/A
Total Investments/Average Interest Rate	**42,336,530**		**1.87%**	

4.12. As the table above indicates, investments at 30 September 2019 totalled £42.34 million with an average rate of interest of 1.87% (2018/19 0.92%). Over the first half of 2019/20 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.

4.13. It should be noted that £17.3 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 £116,000.

4.14. The above details the counterparties that the Council had placed investments with at 30 September 2019. The graph overleaf 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 2018/19 and 2019/20. 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.

4.15. Council agreed, 11 September 2019, to consider its carbon footprint and divest from fossil fuel investments. Currently 24% of our portfolio is invested in diversified funds which invest in equities and therefore carry a small risk of fossil fuel investments. Security, Liquidity and Yield are the Council's main priority (in accordance with the CIPFA Code for treasury investments); however fossil free investment portfolios are likely to outperform standard investments therefore by default our investments will inevitably shift to non-fossil based investments.



Borrowing

4.16. 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.

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

4.18. The need to externally borrow is now anticipated to be in 2020/21 hence the Operational Boundary is projected to be zero (see **Appendix A**).

4.19. 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 2019-20 was £16.506m and revised largely due to carry forwards giving a current budget of £27.160m. The projected outturn is £13.630m – resulting in an estimated underspend of £13.530m. Explanations for this are explained in the Performance and Finance report to the Corporate Overview Group.

(b) Financing costs to net revenue stream – improved position anticipated due to higher investment returns and projected underspends in net service expenditure.

(c) Expected investment position – linked to underspend on the capital programme- see (a) above.

(d) Capital Financing Requirement – the opening position will increase due to internal borrowing associated with Cotgrave/Cotgrave Phase 2, Industrial

Units at Moorbridge and Asset Investment Strategy commitments giving a projected end of year position of £15.067m.

Commercial Investments

4.20. 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.

4.21. 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.

4.22. 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.

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

4.24. 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 AIS, as well as pre-existing commercial investments.

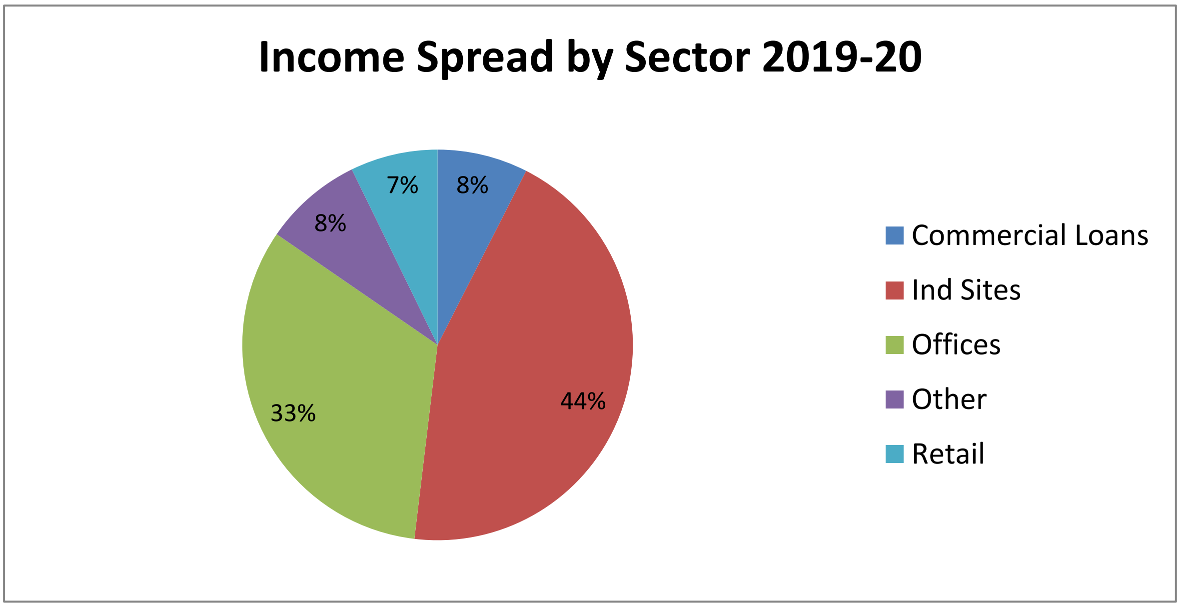
4.25. The expected contributions from commercial investments included in the Asset Investment Strategy are shown below. In order to manage the risk to the Council’s budget, income from commercial investments should not be a significant proportion of the Council’s income. As shown below it is estimated to be around 18% in the current year. Our objective is that this ratio should not exceed 30% in future years, subject to annual review.

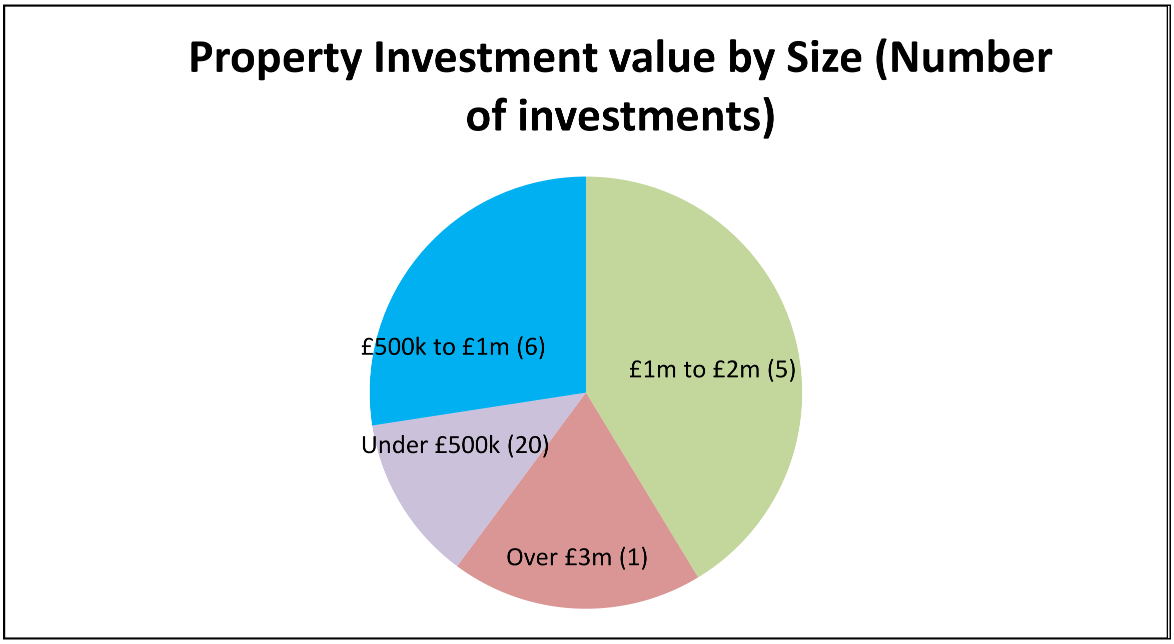
Commercial Investment income and costs

2019/20	Original £000	Current £000	Actual £000	Projected £000
Commercial Property Income	(1,330)	(1,330)	(796)	(1,408)
Running Costs	382	378	53	385
Net Contribution to core functions	(948)	(952)	(743)	(1,023)
Interest from Commercial Loans	(84)	(84)	(42)	(84)
Total Contribution	(1,032)	(1,036)	(785)	(1,107)
Sensitivity:				
+/- 10% Commercial Property Income	133	133	80	141
Indicator:				
Investment Income as a % of total Council Income	18.3%	18.2%	17.2%	17.8%

Risk Exposure Indicators

4.25 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

4.26. 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.

4.27. 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.

4.28. 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.

4.29. 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

4.30. During 2019/20 the Council held a competitive tender process and as a result has new Treasury Management Advisors. Link Asset Services have been appointed as the Council's treasury Management Advisors until 31 October 2022. Their first presentation and training session to Members was on 27 November 2019.

5 Conclusion

5.1. Treasury Management continues to be fraught with difficulty. The UK economy is more uncertain given the impending General Election and whilst 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 Governance Scrutiny Group.

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. Financial Implications

Financial implications are covered in the body of the report.

8.2. Legal

There are no implications identified for this report.

8.3. Equalities Implications

There are no equalities implications identified for this report.

8.4. Section 17 of the Crime and Disorder Act 1998 Implications

There are no implications identified in this report.

8.5. Corporate Priorities

Quality of Life	No direct impact
Efficient Services	Responsible income generation and maximising returns
Sustainable Growth	No direct impact
The Environment	Helping to protect the environment by consideration of carbon footprint and fossil-based investments as referred to in paragraph 4.16

9 Recommendations

It is recommended that Members note the Capital and Investment Management update position at 30 September 2019.

For more information contact:	Peter Linfield Executive Manager - Finance and Corporate Services 0115 914 8439 plinfield@rushcliffe.gov.uk
Background papers available for inspection	Treasury Management Strategy 2019/20
List of Appendices (if any):	Appendix A – Prudential and Treasury Indicators for 2019/20 position at 30 September 2019

APPENDIX A

Prudential and Treasury Indicators for 2019/20
Position at 30 September 2019

	2019/20 £'000 Original Estimate	2019/20 £'000 Revised Estimate
Prudential Indicators		
Capital Expenditure	16,506	13,630
Proportion of financing costs to net revenue streams	(6.88%)	(4.41%)
Expected Investment Position	12,494	25,780
Capital Financing requirement as at 31 March 2020	19,927	15,067
Treasury Management Indicators		
Authorised Limit for external debt Borrowing and other long term liabilities	25,000	25,000
Operational Boundary for external debt Borrowing and other long-term liabilities	20,000	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	6,800	21,200

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