Rushcliffe Borough Council

Governance Scrutiny Group

Thursday, 30 July 2020

Capital and Investment Strategy Outturn 2019/20

Report of the Executive Manager – Finance and Corporate Services

1 Purpose of report

1.1 The purpose of this report is to summarise the transactions undertaken during the 2019/20 financial year reporting against the Council's Capital and Investment Strategy 2019/20-2023/24.

1.2 During the year, the Governance Scrutiny Group received the half-yearly asset and investment management update report on 3 December 2019 and a training session from the Council's new treasury advisors, Link, which was well received by Councillors.

1.3 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.

1.4 The report also highlights issues arising linked to Covid19 which impacted on the Council's year-end investments position and the overall council budget in 2020/21.

2 Recommendation

It is RECOMMENDED that the Governance Scrutiny Group:

a) Agree the 2019/20 outturn position; and

b) Recommend to Full Council as part of the MTFS the reduction in Minimum Revenue Provision (MRP) (paragraph 4.9) and subsequent release of New Homes Bonus to either support the budget gap resulting from Covid19 or to make Voluntary Repayment Provision (VRP) at a later date.

3 Reasons for Recommendation

3.1 The 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 2019/20. 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 Council has identified a significant budget gap resulting from Covid19 which will not be mitigated entirely by government financial support. Reducing the MRP charge to the revenue account releases New Homes Bonus which then can be utilised to support the budget.

4 Supporting Information

A) TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2019/20, 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	2018/19 Actual £000	2019/20 Estimate £000	2019/20 Actual £000
Capital Expenditure	6,748	16,506	6,061
Capital Financing Requirement	8,300	15,067	7,300
Investments	(30,261)	(16,814)	(35,090)

4.2 The approved capital programme for 2019/20 was £16.506m, with £13.118m brought forward from 2018/19 less further adjustments of £4.322m during the year giving a total provision for the year of £25.302m. Actual expenditure against the approved programme was £6.061m (24%) giving rise to a variance of £19.241m. Carry forwards of £19.181m were approved by Cabinet on 14 July 2020 (see paragraph 4.32). The increase in the Investments balance between years reflects slippage in the Capital Programme.

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:

	2018/19 Actual £000	2019/20 Estimate £000	2019/20 Actual £000
Capital Expenditure	**6,748**	**16,506**	**6,061**
Less Financed by:			
Capital Receipts	(4,754)	(4,414)	(5,196)
Capital Grants	(1,862)	(2,439)	(811)
Reserves	(132)	(50)	(54)
Increase in Borrowing Need	**0**	**9,603**	**0**

Significant slippage in capital expenditure mitigated any need to borrow in 2019/20 and all of the expenditure was financed from the Council's capital resources.

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 2019/20 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 For 2017/18, 2018/19, and 2019/20 the Council decided to set the MRP at £1m. This comprises £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. Up until 31.03.20, the Council released an equivalent sum (£1m) from the New Homes Bonus (NHB) Reserve to offset any impact of the borrowing charge to the tax payer in-year. It is proposed that the Council take the option to reduce the VRP element of the charge, giving the option to either release NHB to help meet the budget gap as a result of Covid19 or pay VRP at a later date. By reducing the VRP the Council would free up significant resources (up to £730k in 2020/21) and up to £600k each year to 2024/25. By only making MRP payments this means the length of time payments are being made from the revenue budget for the Arena increase from 10 years to 28 years (3 years have already been discharged).

4.10 The Council's CFR for 2019/20 represents a key prudential indicator and is shown below. The table shows that no additional borrowing was needed in 2019/20 giving rise to a reduction in the CFR of £1m, after deducting the MRP of £1m in 2019/20.

Capital Financing Requirement (CFR)	**2018/19 Actual £000**	**2019/20 Actual £000**
Opening Balance	**9,300**	**8,300**
Add: unfinanced Capital Expenditure (per above)	0	0
Less: MRP/VRP	(1,000)	(1,000)
Closing Balance	**8,300**	**7,300**

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 did not need to resort to external borrowing during 2019/20 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 lower than originally estimated and 2018-19 actual primarily as a result of income from investments exceeding expectations.

	2018/19 Actual £000	**2019/20 Estimate £000**	**2019/20 Actual £000**
General Fund	4.90%	6.77%	2.68%

Upper Limits for Fixed and Variable Rate Exposure

4.16 The purpose of these indicators is to allow the Council to manage the extent to which it is exposed to changes in interest rates:

	2019/20 Limit	2019/20 Actual
Fixed Upper Limit for Fixed Interest Rate Exposure	50%	22%
Variable Upper limit for Variable Interest Rate Exposure	100%	78%

Upper Limit for Total Principal Sums invested over 1 year

4.17 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.

	2019/20 Limit £000	2019/20 Actual £000
Upper Limit for Total Principal Sums Invested over 364 days	8,400	5,000

Treasury Position at 31 March 2020

4.18 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 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 2019/20.

Financial Institution	Amount £	Length of Investment	Interest
OLA - Cambridgeshire CC	5,000,000	12 Months	0.80%
OLA - Guildford Borough Council	5,000,000	12 Months	0.95%
OLA - Lancashire County Council	5,000,000	2 Years	1.20%
Blackrock	380,238	Call	0.42%
Federated	2,931,509	Call	0.41%
Goldman Sachs Asset Management	94,387	Call	0.27%
HSBC	2,289,496	Call	0.38%

Invesco	1,337,008	Call	0.43%
Aberdeen Asset Management	744,231	Call	0.47%
Bank of Scotland Plc	110,653	32 Days	0.95%
Barclays	263,770	32 Days	0.75%
Residual MMF/Call Account balances	32,679	Call	0.36%
Royal London Cash Plus Fund	991,347	On-going	1.42%
CCLA Property Fund	2,070,647	On-going	4.62%
CCLA Diversified Income Fund	1,779,479	On-going	3.00%
Kames Diversified Income Fund	3,358,073	On-going	4.16%
Investec Diversified Income Fund	3,706,999	On-going	3.29%
Total Investments/Average Interest Rate	**35,090,516**		**1.73%**

The Strategy for 2019/20

4.19 The expectation for interest rates within the strategy for 2019/20 anticipated that short term money market rates would remain the same in light of uncertainties surrounding Brexit outcomes and the evolution of the global economy and that the Bank Rate would stay at 0.75%. 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. The onset of Covid19 resulted in further challenges in terms of cash flow, market volatility and Base Rates. To mitigate any potential cash flow issues the Council investments are being placed in short-term liquid assets which have affected (and will continue to affect) the level of interest that could be achieved from investments and the underlying value of these assets.

Investment Rates and Outturn Position in 2019/20

4.20 On 11 March 2020 the Bank of England Base Rate decreased from 0.75% to 0.25%. On 19 March 2020, the Bank of England decreased the base rate from 0.25% to 0.10% which continues to have a significant impact on investment income. Whilst the Council continues to ensure investments are secure, the Council is proactively looking to maximise its rate of return. Despite setbacks the overall rate of return on investments for the year was 1.73% which compares with the budgeted rate of 0.75%. This improved return together with underspends on the capital programme has resulted in an increased net return on investments of £638,416 against an adjusted budget of £201,500. (The budget had included costs of £83,500 for borrowing which didn’t materialise). The fair value of the Councils diversified funds fell by £1.238m at 31.3.2020. These are expected to bounce back. During the past 3 months the values have increased by £500,175:-

Fair Value	31.03.2020	30.06.2020
Kames	3,358,073	3,620,548
Investec	3,706,999	3,907,756
RLAM	991,347	1,002,092
CCLA Property	2,070,647	1,988,291
CCLA Divesified	1,779,479	1,888,033
	11,906,545	**12,406,720**

4.21 The Council's investment policy is governed by the annual Capital and Investment Strategy approved by Council on 7 March 2019 (and prior to this approved by the Corporate Governance Group on 7 February 2019). 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.

4.22 The Council's longer-term cash balances comprise primarily of 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 remain in a healthy position given the on-going financial challenges going forward.

Balance Sheet Resources	31 March 2019 £000	31 March 2020 £000
General Fund Balance	2,604	2,604
Earmarked Reserves	11,818	13,737
Usable Capital Receipts	7,036	3,538
Capital Grants Unapplied	98	220
Total	**21,556**	**20,099**

Conclusion – Treasury Management

4.23 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). Covid19 presents risks and we will continue to closely monitor these.

B) ASSET INVESTMENT STRATEGY

Overview

4.24 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 Council's Asset Investment Strategy falls within the definition of the guidance.

4.25 This section of the report reviews the current position and the issues that influenced the Asset Investment Group's future approach to investments.

Investments 2019/20

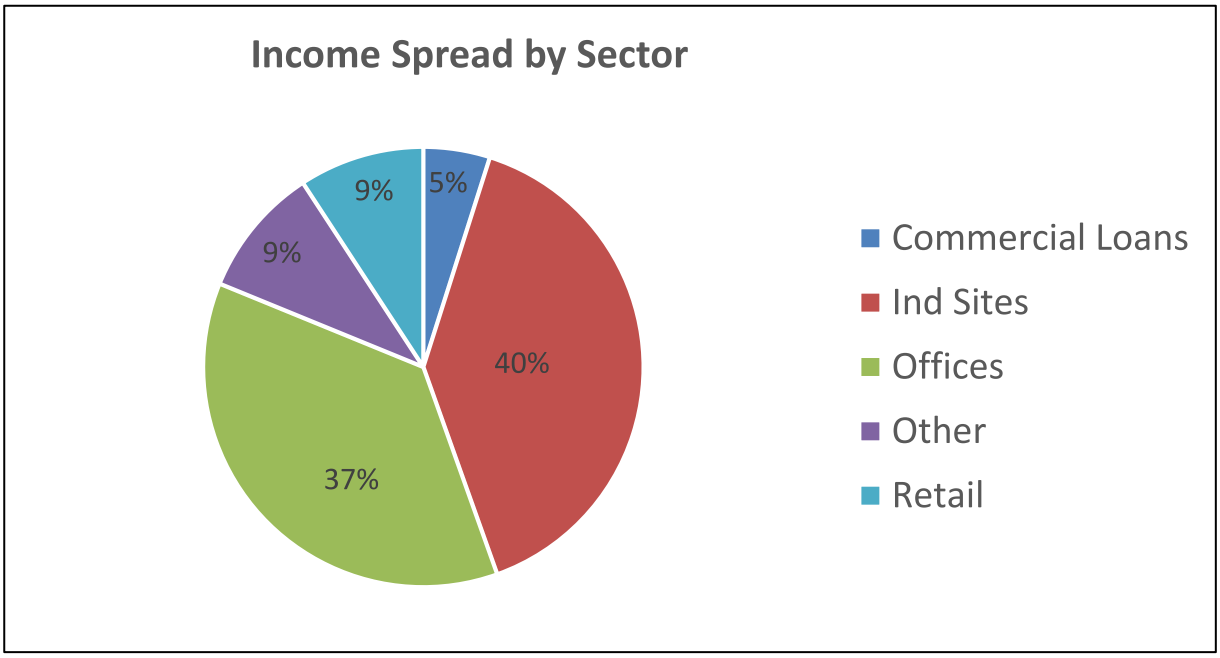
4.26 2019/20 was a very uncertain year with a General Election, both Brexit negotiations and latterly Covid19 affecting the economy. The changing risk profile has meant some investments have not been pursued. Also, the unutilised part of NCCC Loan £750k was returned to AIS re Cabinet (9 Dec 19) although £14.5k was reallocated towards the end of the year. During the year, the Asset Investment Group have agreed to proceed with two new asset acquisitions and investments, and these will be reported at a future meeting when legally completed, given their confidential nature.

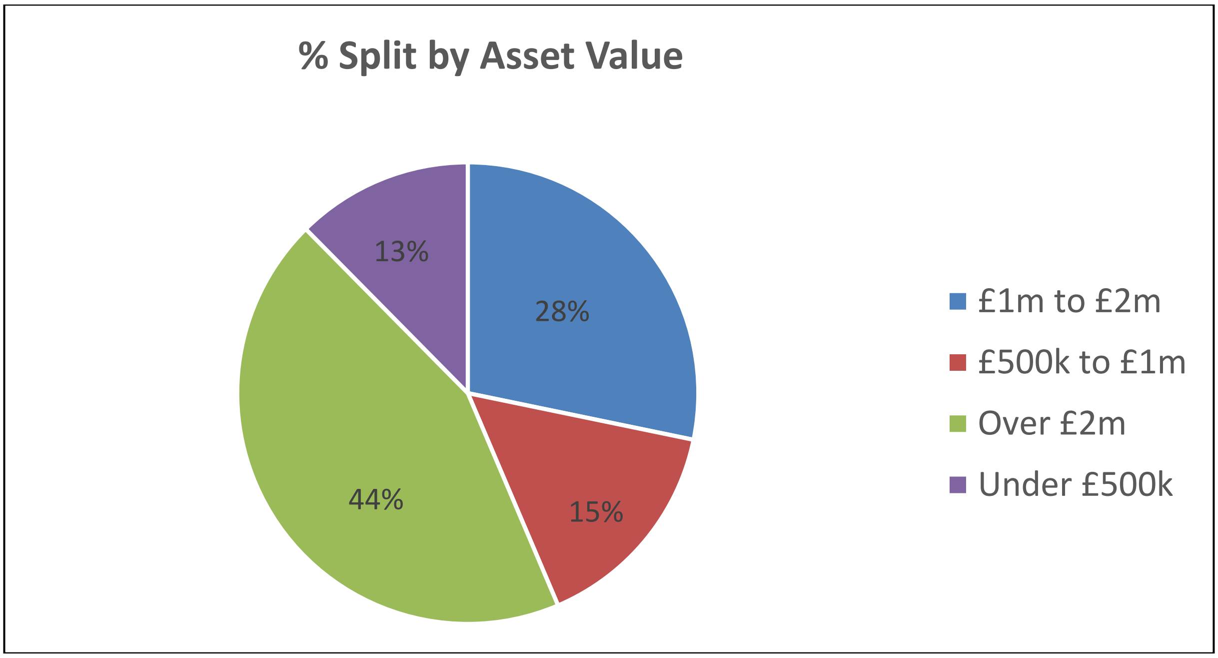
Current Position

4.27 In terms of the Asset Investment Strategy, the funds allocated and available, the table below exemplifies the current position and significant work undertaken primarily by the Property, Legal and Finance teams. Currently £3.828m remains unallocated from the original £20m provision.

Total Spend	Gross Return	Investment	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
1,964,500	3.25%	NCCC Loan (interest)	76,922	73,634	70,460	67,148	63,864	63,864
1,477,500	4.67%	Trent Boulevard (Co-op)	69,000	69,000	69,000	69,000	69,000	69,000
984,000	6.76%	Finch Close	66,500	66,500	66,500	66,500	66,500	66,500
1,917,000	6.26%	Bardon	120,000	120,000	120,000	120,000	120,000	120,000
2,500,000	6.40%	Cotgrave - New Offices	36,506	40,000	40,000	40,000	40,000	40,000
		Cotgrave- Ind Units	120,502	120,000	120,000	120,000	120,000	120,000
860,000	6.98%	Boundary Court	60,801	60,000	60,000	60,000	60,000	60,000
1,900,000	4.79%	Cotgrave Phase 2			34,000	91,000	91,000	91,000
2,471,000	4.86%	Committed Scheme 1		17,100	120,000	120,000	120,000	120,000
2,098,000	5.24%	Committed Scheme 2			110,000	110,000	110,000	110,000
16,172,000	**3.50%**	**Totals**	550,231	566,234	809,960	863,648	860,364	860,364
3,828,000	5.50%	Outstanding balance	210,540	210,540	210,540	210,540	210,540	210,540

4.28 If we look at the Council's overall property portfolio (this excludes the loan to NCCC), there is a good spread of risk (classifying by the rental earned or the asset value), as depicted below:





4.29 From the above, there is more investment in the industrial sector given much of the property investment, in the past, has been about economic growth and regeneration within the Borough. More recent acquisitions have been in retail and office spreading the risk from income streams.

4.30 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%.

Commercial Investment income and costs

	2020/21 £'000	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000
Commercial Property Income	(1,550)	(1,727)	(2,119)	(2,164)	(2,211)
Running Costs	495	495	496	496	496
Net Contribution to core functions	(1,055)	(1,232)	(1,623)	(1,668)	(1,715)
Interest from Commercial Loans	(98)	(90)	(82)	(74)	(68)
Total Contribution	(1,153)	(1,322)	(1,705)	(1,742)	(1,783)
Sensitivity:					
+/- 10% Commercial Property Income	155	173	212	216	221
Indicator:					
Investment Income as a % of total Council Income	20.3%	22.2%	25.5%	25.7%	26.0%

The Way Forward

4.31 The Council's original intention was to look at generating around £1m of additional property rental income to help bridge the anticipated budget deficit, and the majority of this, 86%, will be achieved by 2022/23 (see table at paragraph 4.27). The AIG decided to rein in its commercial investment activity given risks within the property market and the amount of capital investment required. Currently, there is consultation regarding PWLB future lending terms. Restrictions may apply for those Local Authorities pursuing a Commercial agenda.

4.32 Cabinet 14 July 2020 approved the carry forward of £19.181m capital underspends into 2020/21 including £8.382m on the Asset Investment Strategy (AIS). This comprises: £1.750m originally allocated for Industrial Units at Moorbridge (no longer proceeding) and £6.632m AIS underspend. Of the £8.382m, £4.554m is the balance committed to investments due to be acquired by September 2020 leaving £3.828m unallocated. The use of this unallocated sum will be considered in light of the above.

Conclusion

4.33 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 and the legacy of Covid19 is still to be determined. Failure to deliver additional income streams will increase the requirement to identify further efficiencies or utilise reserves in the short to medium term. Such decisions will be considered and reported as part of the MTFS 2021/22 budget process and be reported in financial reports in 2020/21.

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 of the impact of Covid19 and its effect on different asset classes including investment properties, office accommodation etc. It is important that the Council 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 4.29-4.30).

6 Implications

6.1.1 Financial Implications

Financial implications are covered in the body of the report.

6.2 Legal Implications

The report is in compliance with the Local Government Act 2003.

6.3 Equalities Implications

There are no equalities implications to the recommendations of this report.

6.4 Section 17 of the Crime and Disorder Act 1998 Implications

There are no Section 17 implications to the recommendations of this report.

7. Link to Corporate Priorities

Quality of Life	Efficient and effective treasury and property management supports all of the Council's corporate priorities
Efficient Services	
Sustainable Growth	
The Environment	

8. Recommendations

It is RECOMMENDED that the Governance Scrutiny Group:

a) Agree the 2019/20 outturn position; and

b) Recommend to Full Council as part of the MTFS the reduction in Minimum Revenue Provision (MRP) (paragraph 4.9) and subsequent release of New Homes Bonus to either support the budget gap resulting from Covid19 or to make Voluntary Repayment Provision (VRP) at a later date.

For more information contact:	Name; Peter Linfield Executive Manager – Finance and Corporate Services 0115 914 8439 email plinfield@rushcliffe.gov.uk
Background papers Available for Inspection:	Statement of Accounts 2019/20; Capital and Investment Strategy 2019/20; Treasury Management Update – Mid-Year Report 2019/20
List of appendices (if any):	**Glossary of Terms**

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.