Rushcliffe Borough Council

Governance Scrutiny Group

Thursday, 23 September 2021

Capital and Investment Strategy Outturn 2020/21

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 2020/21 financial year reporting against the Council's Capital and Investment Strategy 2020/21-2024/25.

1.2 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.

1.3 The report also highlights issues arising linked to Covid-19 which impacted on the Council's year-end investments position and the overall council budget in 2020/21.

2 Recommendation

2.1 It is RECOMMENDED that the Governance Scrutiny Group agrees the 2020/21 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 2020/21. 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 Prudential Code is currently being reviewed and following a consultation exercise CIPFA have just announced that proportionality will be included as an objective, clarification and definitions to define commercial activity and investment will be included, and that the purchase of commercial property purely for profit cannot lead to an increased capital financing requirement (CFR). CIPFA will also introduce a liability benchmark as a treasury management indicator. The revised Prudential Codes is expected to be published in December 2021. It is important to note the section on commercial investments from paragraph 4.26 does cover the issue of proportionality with different types of asset investments the Council has made.

4 Supporting Information

TREASURY MANAGEMENT

Prudential Indicators Summary

4.1 During 2020/21, 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	2019/20 Actual £000	2020/21 Estimate £000	2020/21 Actual £000
Capital expenditure	6,061	18,936	9,306
Capital Financing Requirement	7,300	21,849	7,300
Investments	(35,090)	(14,328)	(47,127)

4.2 The approved capital programme for 2020/21 was £18.936m, with £19.179m brought forward from 2019/20 less further adjustments of £3.520m and agreed reprofiling of £18.465m during the year giving a total provision for the year of £16.130m. Actual expenditure against the approved programme was £9.306m (58%) giving rise to a variance of £6.824m. Carry forwards of £6.682m were approved by Cabinet as part of the Final Outturn Report. The increase in the Investments balance between years reflects slippage in the Capital Programme and additional S106 deposits.

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:

	2019/20 Actual £000	2020/21 Estimate £000	2020/21 Actual £000
Capital Expenditure	**6,061**	**18,936**	**9,306**
Less Financed by:			
Capital Receipts	(5,196)	(14,922)	(7,600)
Capital Grants	(811)	(2,428)	(1,557)
Reserves	(54)	(70)	(149)
Increase in Borrowing Need	**0**	**1,516**	**0**

Significant slippage in capital expenditure mitigated any need to borrow in 2020/21 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 2020/21 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 taxpayer in-year. This practice will continue over the next few years although with new schemes increasing borrowing requirements the amount of VRP to finance the Arena will be reduced to cushion the impact. This in turn will increase the number of years to repay the Arena debt (from 10 years to 12 years).

4.10 The Council's CFR for 2020/21 represents a key prudential indicator and is shown below. The table shows that no additional borrowing was needed in 2020/21 giving rise to a reduction in the CFR of £1m, after deducting the MRP of £1m in 2020/21.

Capital Financing Requirement (CFR)	**2019/20 Actual £000**	**2020/21 Actual £000**
Opening Balance	**8,300**	**7,300**
Add: unfinanced Capital Expenditure (per above)	0	0
Less: MRP/VRP	(1,000)	(1,000)
Closing Balance	**7,300**	**6,300**

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 2020/21 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 primarily as a result of income from investments exceeding expectations and additional Covid grants although a significant proportion of these were transferred to reserves to meet future commitments.

	2019/20 Actual	2020/21 Estimate	2020/21 Actual
General Fund	2.68%	5.88%	2.81%

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:

	2020/21 Limit	2020/21 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.

	2020/21 Limit £000	**2020/21 Actual £000**
Upper Limit for Total Principal Sums Invested over 364 days	7,200	0

Treasury Position at 31 March 2021

4.18 The Council's debtand 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 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 2020/21.

Financial Institution	Amount £	Length of Investment	Interest
OLA - Cornwall	5,000,000	90 Days	0.80%
OLA - Lancashire County Council	5,000,000	2 Years	1.20%
Police & Crime Commissioner - Nottm	5,000,000	6 months	0.12%
Aviva Investors	89,210	Call	0.00%
Blackrock	500,774	Call	0.01%
Federated	1,696,393	Call	0.01%
Goldman Sachs Asset Management	53,756	Call	0.00%
Handelsbanken	412,000	Call	0.00%
HSBC	3,625,121	Call	0.01%
Invesco	843,046	Call	0.01%
Bank of Scotland	4,377,793	Call	0.05%
Bank of Scotland	108,002	32 Days	0.10%
Barclays Bank	765,237	32 Days	0.02%
Handelsbanken	2,500,560	35 Days	0.01%
Santander UK	69,580	Call	0.08%
Santander UK	4,003,858	35 Days	0.30%
Residual MMF/Call Account balances	31,090	Call	0.01%
Royal London Cash Plus Fund	1,006,286	On-going	1.38%
CCLA Property Fund	2,055,925	On-going	4.58%
CCLA Diversified Income Fund	1,929,083	On-going	4.58%
Kames Diversified Income Fund	3,989,037	On-going	5.01%
Investec Diversified Income Fund	4,069,297	On-going	4.07%
Total Investments/Average Interest Rate	**47,126,047**		**0.68%**

The Strategy for 2020/21

4.19 The expectation for interest rates within the strategy for 2020/21 anticipated that short term money market rates would remain the same in light of uncertainties surrounding Brexit outcomes, The onset of Covid-19 resulted in further challenges in terms of cash flow, market volatility and reducing interest rates. Interest rates of 0.75% were assumed in the budget but the Base Rate was decreased from 0.75% to 0.25% to 0.10% and remains at this level today. 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. To mitigate any potential cash flow issues the Council investments were placed in short-term liquid assets which have affected (and will continue to affect) the level of interest that can be achieved from investments and the underlying value of these assets.

Investment Rates and Outturn Position in 2020/21

4.20 On the 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. The overall rate of return on investments for the year was 0.68% compared with the budgeted rate of 0.75%. Despite setbacks, Covid grants from the Government, 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 £681,057 against an adjusted budget of £365,800. (The budget had included costs of £76,300 for borrowing which didn't materialise). The fair value of the Council's diversified funds fell by £1.238m at 31/3/20. These were expected to bounce back and during 2020/21 the values increased by £1.143m shown below. There continues to be fluctuations on these funds with a net favourable variance of £0.070m (excluding CCLA Property Fund) currently being reported during the first 3 months of 2021/22.

Fair Value	31.03.2020	31.03.2021
Kames	3,358,073	3,989,037
Investec	3,706,999	4,069,297
RLAM	991,347	1,006,286
CCLA Property	2,070,647	2,055,925
CCLA Divesified	1,779,479	1,929,083
	11,906,545	**13,049,628**

4.21 The Council's investment policy is governed by the annual Capital and Investment Strategy approved by Council on 5 March 2020 (and prior to this approved by the Governance Scrutiny Group on 6 February 2020). 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. The increase between years primarily relates to Government Grants in relation to reimbursement for additional NDR reliefs issued during the year. These have been appropriated to the newly created earmarked reserve for the Collection Fund (as referenced in the 2020/21 financial outturn report to Cabinet).

Balance Sheet Resources	31 March 2020 £000	31 March 2021 £000
General Fund Balance	2,604	2,604
Earmarked Reserves	13,473	22,365
Usable Capital Receipts	3,537	493
Capital Grants Unapplied	220	364
Total	**19,834**	**25,826**

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). Covid-19 presented risks and we will continue to closely monitor these as the economy enters its recovery phase.

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. Following a recent consultation exercise, CIPFA has just announced that the Prudential Code will be amended so that the purchase of commercial property purely for profit cannot lead to an increased capital financing requirement (see paragraph 3.1). The Council's Asset Investment Strategy falls within the definition of the guidance. The Council allocated £20m to the Asset Investment Strategy within the Capital Programme to support commercial investment in areas such as investment in property and subsidiaries, or loans that support service outcomes. The balance at the start of 2020/21 was £8.382m

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 2020/21

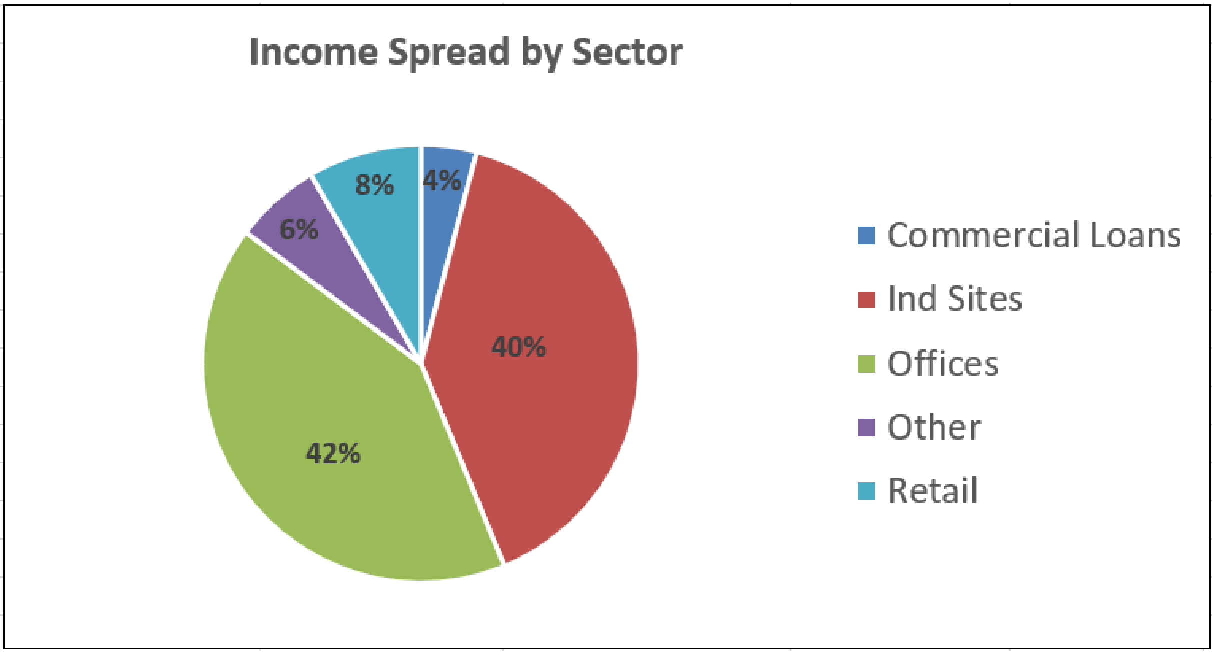
4.26 2020/21 was a very uncertain year with both Brexit negotiations and Covid-19 affecting the economy. During this period the Council acquired Unit 1 Edwalton Business Park closely followed by Unit 3 in October 2020. The changing risk profile meant some investments were not pursued and the balance of £3.828m of the asset investment fund was removed from the Programme as part of the MTFS.

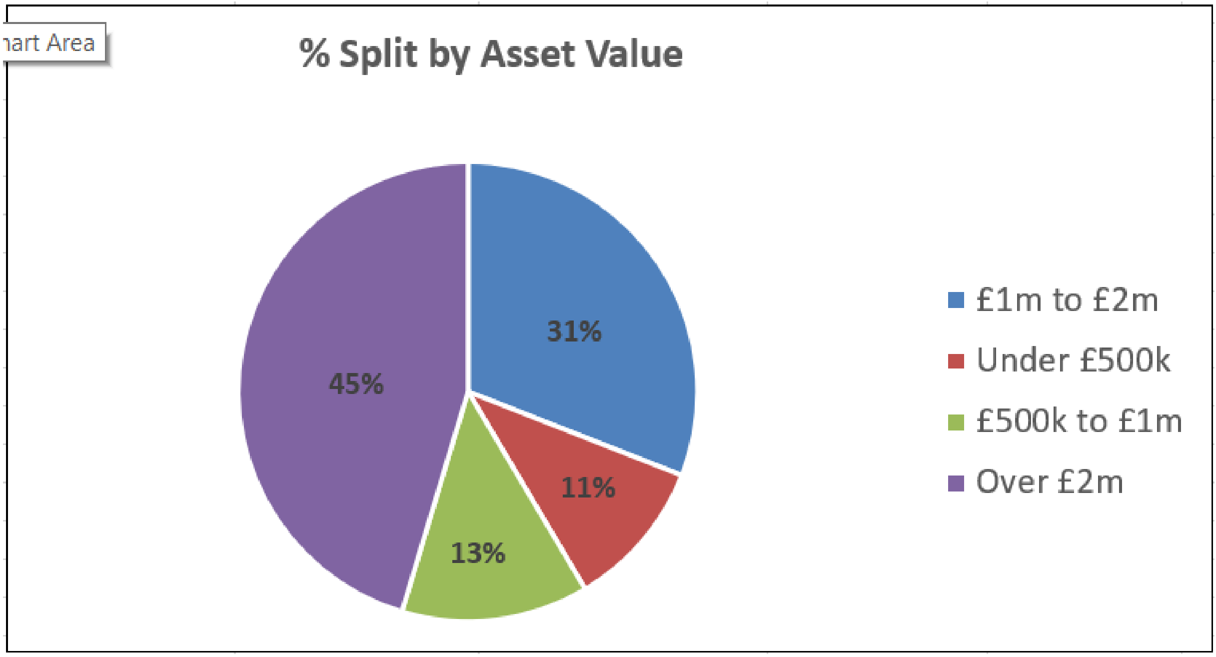
Current Position

4.27 The table below shows how the Asset Investment Strategy funds have been allocated and returns being made. When compared to the rates of interest on cash investments this demonstrates the benefit of a diversified approach of investing in both cash and assets. Differing rates of return and risk profiles, providing a balanced and proportionate approach to investments. Additional assets acquired this year were the Edwalton Business Units (reported in the 6 monthly update report to Corporate Governance Group).

Total Spend £	Gross Return	Investment	2020-21 £	2021-22 £	2022-23 £	2023-24 £	2024-25 £	2025-26 £
1,964,500	3.28%	NCCC Loan (interest)	74,912	71,093	67,754	64,398	60,509	56,833
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	66,504	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	42,411	40,000	40,000	40,000	40,000	40,000
		& Cotgrave- Ind Units	120,201	120,000	120,000	120,000	120,000	120,000
860,000	6.98%	Boundary Court	67,122	60,000	60,000	60,000	60,000	60,000
1,900,000	4.79%	Cotgrave Phase 2	-	25,000	65,000	91,000	91,000	91,000
2,450,790	5.59%	Unit 3 Edwalton Business	-	136,900	136,900	136,900	136,900	136,900
2,083,364	5.28%	Unit 1 Edwalton Business	77,804	110,000	110,000	110,000	110,000	110,000
16,137,154	**3.95%**	**Totals**	**637,954**	**818,493**	**855,154**	**877,798**	**873,909**	**870,233**
3,862,846	**RETURNED**							

4.28 If we look at the Council's overall property portfolio 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 accommodation, 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%.

<u>Commercial Investment income and costs</u>

	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000	2025/26 £'000
Commercial Property Income	(1,660)	(2,015)	(2,160)	(2,240)	(2,302)
Running Costs	516	517	517	517	517
Net Contribution to core functions	(1,144)	(1,498)	(1,643)	(1,723)	(1,785)
Interest from Commercial Loans	(89)	(81)	(72)	(64)	(59)
Total Contribution	(1,233)	(1,579)	(1,715)	(1,787)	(1,844)
Sensitivity:					
+/- 10% Commercial Property Income	166	202	216	224	230
Indicator:					
Investment Income as a % of total Council Income	22.8%	24.7%	23.9%	24.3%	24.6%

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. However last year, the AIG decided to rein in its commercial investment activity given risks within the property market and the amount of capital investment required. 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 2022/23 (see table at paragraph 4.27).

4.32 Cabinet 9 February 2021 approved the MTFS which included the Capital Programme and the return of the unallocated balance on the AIS of £3.863m

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 Covid-19 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 were considered and reported as part of the MTFS 2021/22 budget process.

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 Covid-19 and its effect on different asset classes including investment properties, office accommodation, retail 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 4.28-4.30).

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.

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 agrees the 2020/21 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 2020/21; Capital and Investment Strategy 2020/21; Treasury Management Update – Mid-Year Report 2020/21
List of appendices (if any):	**Appendix 1 - Glossary of Terms**

Appendix 1

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.