Rushcliffe Borough Council	**Governance Scrutiny Group** **Thursday, 25 November 2021** **Capital and Investment Strategy Mid-Year Report 2021/22**

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 2021.

1.2. The Capital and Investment Strategy for 2021/22, approved by Council on 4 March 2021 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 notes the Capital and Investment Strategy up-date position as of 30 September 2021.

3. Reasons for Recommendation

3.1 CIPFA's Code of Practice for Treasury Management (2017) recommends that Councillors 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.

3.2 The Treasury Management Code is currently being reviewed. The main proposals are that going forward monitoring should be quarterly, there should be specific training for members involved in scrutiny and broader training for members who sit on full council, and the introduction of a Liability Benchmark to manage debt risks. Together with proposed changes in the Prudential Code there is a greater focus on climate and environmental, social and governance risks when making financial decisions.

4. Supporting Information

Economic Background

4.1. The Coronavirus outbreak caused huge economic damage to the UK and around the world in 2020/21. With the roll out of the vaccination programme, the recovery is starting to gather pace. In the first six months of 2021/22:

- The economy increased 4.8% in the second quarter of 2021 (April to June 2021), with growth of 6.6% forecast this year and 5.4% in 2022 allowing the economy to reach pre covid levels by the first quarter of next year.
- The Bank of England base rate remains at 0.1% and is expected to stay at this level until June 2022 when it is expected to increase to 0.25% with a further increase to 0.5% in June 2023.

Economic Forecast

4.2. The economy is recovering, with some sectors such as manufacturing and construction, having already recovered most of the ground lost last year. While for sectors such as hospitality and Leisure, the big times are now.

4.3. The recovery is also likely to be uneven across the UK, with strongest growth expected in the West Midlands, London and the East of England. It provides the Government with an opportunity to help poorer regions as part of its levelling up agenda.

4.4. The UK unemployment rate fell to 4.6 percent in the three months to July 2021, the lowest level since the June-August 2020 period and in line with market expectations.

4.5. The current Bank of England base rate remains at 0.1%. Link (the Council's Treasury Advisors) are forecasting no change until June 2022 when they predict rates will increase to 0.25%, with a subsequent increase the following year (June 2023) to 0.5%.

4.6. The consumer price inflation rate in the UK jumped to 3.2% in August of 2021 (3.1% in September), the highest since March 2021, from 2% in July and above market forecasts of 2.9%.

4.7. Overall, the short-term outlook for the economy is favourable. The possible emergence of new variants of the virus that are less responsive to the current vaccines is still a downside risk. With the furlough scheme having ended in September unemployment levels are expected to peak at 5.7% at the end of the year. Rising cost pressures and the reversal of temporary tax cuts will cause inflation to rise this year, but interest rates are not expected to increase before June 2022.

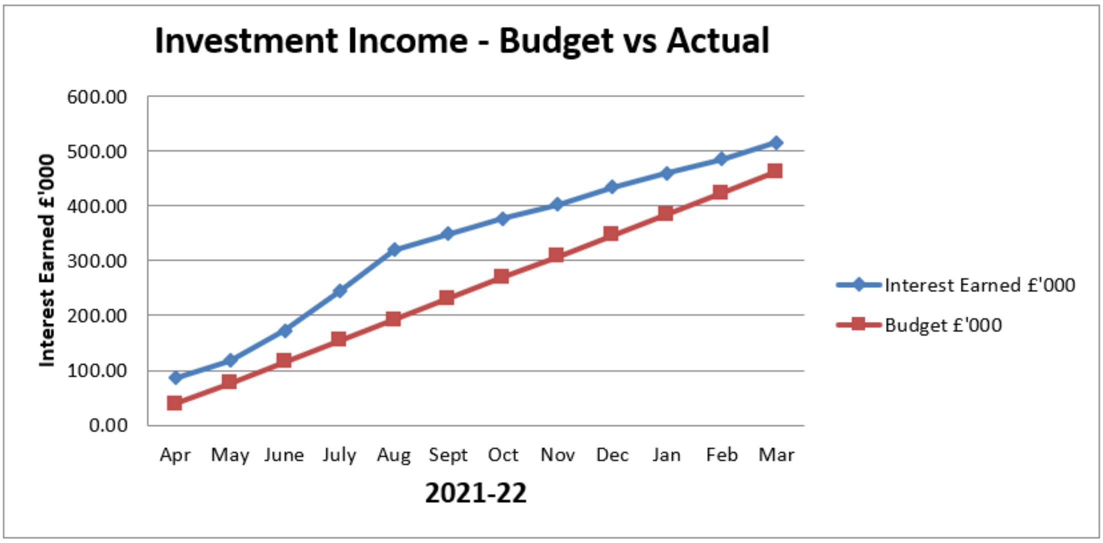
Investment Income

4.8. 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 £462,100 in investment income in 2021/22 (£376,800 in 2020/21). Actual interest earned to 30 September 2021 totalled £349,100 (£297,610 in 2020/21) with total receipts for the year expected to be £516,440 (£440,460 in 2020/21). Interest receipts are higher than estimated due to investing in higher interest earning diversified funds coupled with delays in the capital programme and additional grant funding. All investments have been made in accordance with the Council's Capital and Investment Strategy.

4.9. 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 (MMFs), Call Accounts, CCLA Property Fund, UK Local Authorities and Diversified Funds with a larger amount than normal being held in MMFs to ensure liquidity.

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



4.11. 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 £15 million invested in diversified income and property accounts that are earning on average a rate of 4.56% in interest.

Benchmark	2021-22 LIBID	Council Performance
Instant Access	0.08%	0.00%
1 month	0.07%	0.06%
3 months	0.05%	-
6 months	0.02%	0.06%
12 months +	0.07%	1.64%

4.12. The table below highlights the level of investment activity and the rates obtained at 30 September 2021. Investments were made in line with Link's approved counterparty list.

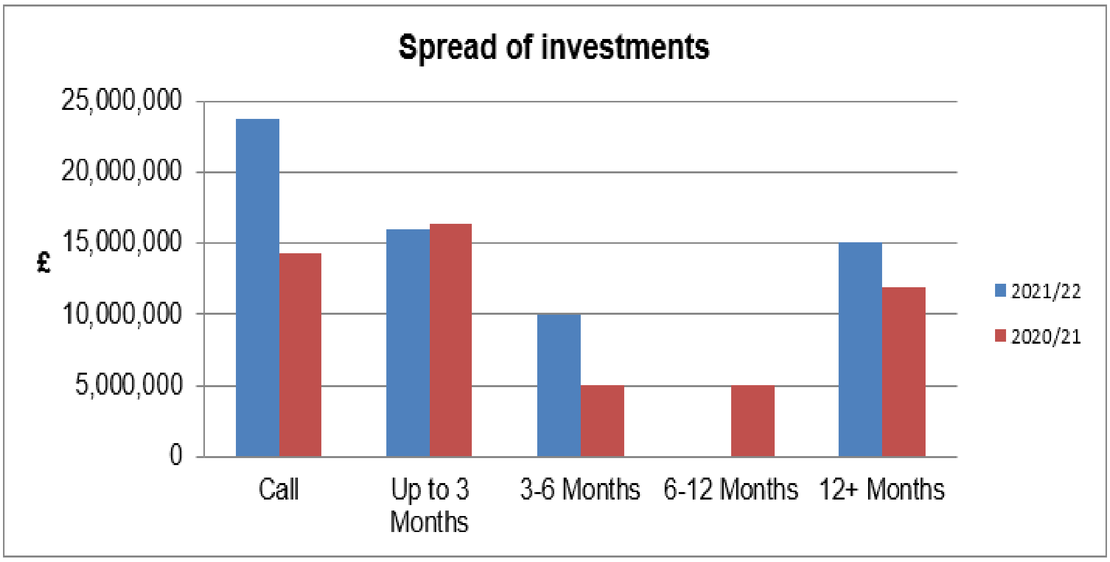
Financial Institution	Amount £	Length of Investment	Interest
Goldman Sachs Asset Management	5,000,000	183 days	0.12%
Lancashire County Council	5,000,000	2 Years	1.20%
Blackrock	3,950,860	Call	0.01%
Federated Investors (Uk)	4,530,588	Call	0.01%
Handelsbanken Plc	2,412,000	Call	0.00%
Hsbc Asset Management	1,769,841	Call	0.01%
Invesco Aim	2,102,201	Call	0.01%
Aberdeen Asset Management	4,350,290	Call	0.01%
Bank Of Scotland Plc	4,377,793	Call	0.05%
Bank Of Scotland Plc	108,016	32 Days	0.03%
Barclays Bank Plc	4,356,126	32 Days	0.02%
Handelsbanken Plc	2,500,685	35 Days	0.01%
Santander Uk Plc	4,009,917	35 Days	0.30%
Residual MMF/Call Account Balances	261,517	Call	0.00%
Close Brothers	5,000,000	98 Days	0.25%
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	4,989,037	On-going	5.01%
Investec Diversified Income Fund	5,069,297	On-going	4.07%
Total Investments/Average Interest Rate	**64,779,463**		**1.16%**

4.13. As the table above indicates, investments as of 30 September 2021 totalled £64.779m compared with £40.173m in 2020/21. The average rate of interest was 1.16%, higher than previous year (0.74% 2020/21). This is because funds available for investment far exceeded those in the preceding year primarily as a result of the receipt of grants and progress not as expected on the capital programme. The rates achieved vary between different institutions, for different durations, dependant on when the investment was made.

4.14. With such poor interest rates the Council continues to internally borrow to fund capital expenditure. Whilst the Council continues to ensure investments are secure and liquidity is achieved (in light of uncertain income streams), it is proactively looking to maximise its rate of return.

4.15. It should be noted that £29.3 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 £32,500. See comment

4.16. The above details the counterparties that the Council had investments placed with on 30 September 2021. The graph below 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 2020/21 and 2021/22. A consequence of Covid19, and ensuring liquidity, is that increasingly the Council has been holding investments, over a shorter period of time, with a greater number of institutions. This is compliant with the Council's Capital and Investment Strategy and recommended action by the Council's Treasury advisors.



4.17. Council agreed, 19 September 2019, to consider its carbon footprint and aim to divest from fossil fuel investments. Currently 18.5% (22% in 2020) 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).

4.18. The fair value of the Council's diversified funds fell by £1.238m at 31.3.2020. These were expected to bounce back and during 2020/21 the values had increased by £1.143m. The position to date (see table below) shows that these assets have fully recovered and are now valued at £1.262m above March 2020 values. At the end of July, a further £2m was invested in Kames and Investec (£1m in each, not reflected below). These funds will continue to fluctuate in value but are being held long term.

Fair Value	**31.03.2020**	**31.03.2021**	**30.09.2021**
Kames	3,358,073	3,989,037	3,960,219
Investec	3,706,999	4,069,297	4,042,574
RLAM	991,347	1,006,286	1,003,950
CCLA Property	2,070,647	2,055,925	2,126,334
CCLA Divesified	1,779,479	1,929,083	2,035,552
	11,906,545	**13,049,628**	**13,168,629**

Borrowing

4.19. 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 Capital and Investment Strategy Statement.

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

4.21. The need to externally borrow is now anticipated to be nil in 2021/22. The Operational Boundary set for the year is £20m (see **Appendix A**). The Authorised limit is set at £25m and any change in this would require Full Council approval.

4.22. 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 A**. Key comments to note are as follows:

(a) Capital Expenditure – The original budget for 2021/22 was £28.158m and revised largely due to carry forwards giving a current budget of £35.602m. The programme was reviewed in the light of Covid19 impact and re-phasing of £6.533m was requested together with the budget adjustments of £0.911m giving a revised Capital Programme of £35.602m for 2021/22. The projected outturn is around £25m – resulting in an estimated underspend of £10m primarily due to rephasing of Bingham Hub (£2m), the Crematorium (£3m); Leisure Centre Schemes £1m; and Support for Registered Housing Providers £0.9m. This position is reported to both Cabinet and Corporate Overview Group.

(b) Financing costs to net revenue stream – improved position anticipated due to higher investment returns and no debt charges (no external borrowing).

(c) Expected investment position – is expected to be lower due to not externally borrowing as expected and using internal balances in the short term.

(d) Capital Financing Requirement (CFR) – the closing position will be slightly less than budgeted for as a result of capital programme re-phasing as mentioned at (a) above. The CFR projected end of year position is £16.273m.

Commercial Investments

4.23. 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.

4.24. The Council whilst committed to being self-sustainable has taken the decision to no longer invest on property for commercial gain. This accords with the current professional ethos of CIPFA, mentioned below. Hence the Council no longer has an Asset Investment Fund, which was £20m.

4.25. Last year the Council acquired two Business Units in West Bridgford, leaving a balance £3.828m which was removed from the Capital Programme. Under new proposals discussed below Local Authorities will no longer be allowed to borrow to fund non-financial assets solely to generate a profit.

4.26. The Prudential Code is currently being reviewed and following a consultation exercise CIPFA has 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). Pleasingly this has always been a cornerstone of Rushcliffe's investment philosophy. CIPFA is also to 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 4.29 does cover the issue of proportionality with different types of asset investments the Council has made.

4.27. The Authority has to disclose its dependence on commercial income and the contribution non-core investments make towards core functions. This covers assets purchase through the Council's AIS, as well as pre-existing commercial investments.

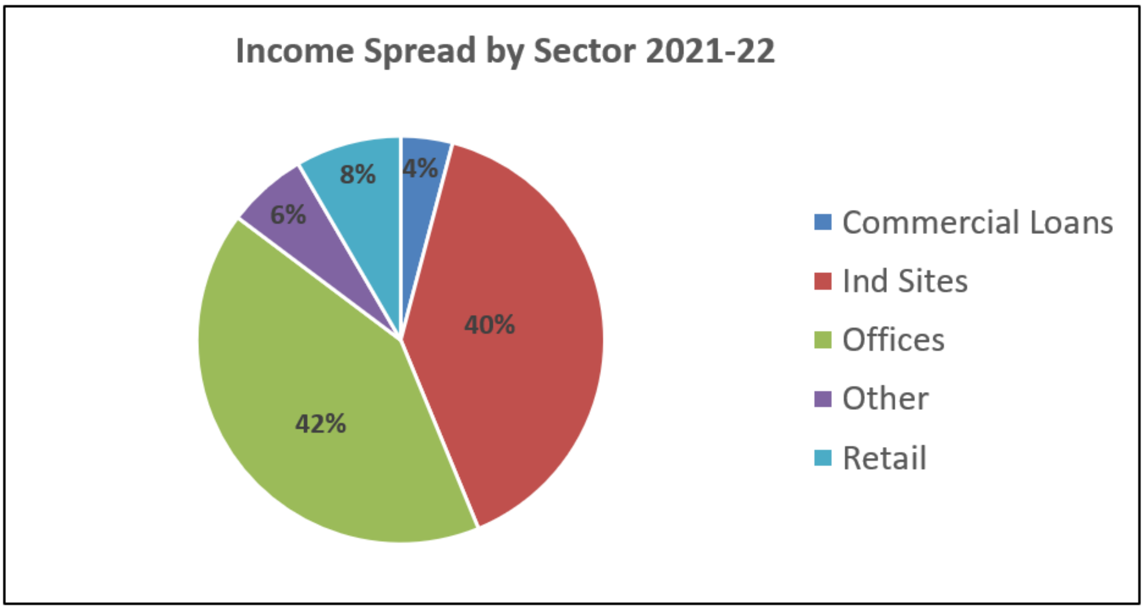
4.28. The expected contributions from commercial investments are shown below. In order to manage the risk to the Council's budget, income from commercial investments should not be a significant proportion of the Council's income. It is estimated to be around 20% in the current year. Our objective is that this ratio should not exceed 30% in future years, subject to annual review.

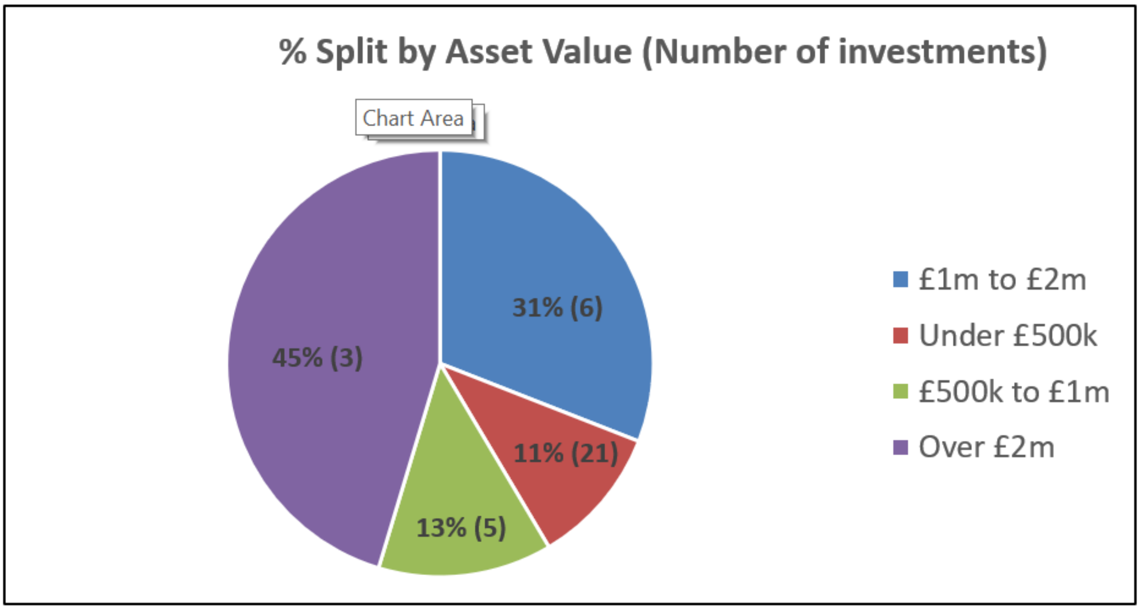
Commercial Investment income and costs

2021/22	Original £'000	Current £'000	Actual £'000	Projected £'000
Commercial Property Income	(1,660)	(1,660)	(862)	(1,621)
Running Costs	516	516	516	516
Net Contribution to core functions	(1,144)	(1,144)	(346)	(1,105)
Interest from Commercial Loans	(89)	(89)	(10)	(89)
Total Contribution	(1,233)	(1,233)	(356)	(1,194)
Sensitivity:				
+/- 10% Commercial Property Income	166	166	86	162
Indicator:				
Investment Income as a % of total Council Income	22.8%	22.8%	12.8%	20.0%
Total Income	7669.3	8172.2	6809	8540.3

Risk Exposure Indicators

4.29. 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. Covid has accelerated remote working which has reduced office occupation during lockdown. There is a risk that this may become a new way of working which could reduce demand for office accommodation although the long-term impact is unknown. This will be monitored and reported in future reports.





Security and Liquidity

4.30. 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.

4.31. 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.

4.32. 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.

4.33. 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

4.34. The Council's Treasury Management Advisors, Link Asset Services held a presentation and training session to Councillors on 9 December 2020 and the next is scheduled for 22 November 2021.

5 Conclusion

5.1. Treasury Management continues to be fraught with difficulty. The UK economy is recovering but interest rates remain low affecting the returns that can be achieved from investments. Changes in accounting codes will restrict what local authorities can do coupled with the threat of borrowing caps. Officers will continue to be vigilant 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 (2017) recommends by informing Councillors of Treasury Management activities at least twice a year. 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

8 Link to 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 4.24

9 Recommendations

It is recommended that the Group notes the Capital and Investment Strategy update position at 30 September 2021.

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 2021/22
List of Appendices (if any):	Appendix A – Prudential and Treasury Indicators for 2021/22 position at 30 September 2021

APPENDIX A

Prudential and Treasury Indicators for 2021/22
Position at 30 September 2021

	2021/22 £'000 Original Estimate	2021/22 £'000 Current Projections
Prudential Indicators		
Capital Expenditure	28,158	25,769
Proportion of financing costs to net revenue streams	5.45%	3.68%
Expected Investment Position (at 31 March 2022)	20,752	16,431
Capital Financing requirement as at 31 March 2022	16,909	16,273
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	20,000
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	10,400	8,200

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