CABINET
24 MARCH 2020

***PART 1 – PUBLIC DOCUMENT**

TITLE OF REPORT: THIRD QUARTER INVESTMENT STRATEGY (CAPITAL AND TREASURY) REVIEW 2019/20

REPORT OF THE SERVICE DIRECTOR - RESOURCES

EXECUTIVE MEMBER: FINANCE AND I.T.

CURRENT COUNCIL PRIORITY: RESPONSIVE AND EFFICIENT

NEW COUNCIL PRIORITY: ENABLE AN ENTERPRISING AND CO-OPERATIVE ECONOMY

1. EXECUTIVE SUMMARY

1.1 To update Cabinet on progress with delivering the capital and treasury strategy for 2019/20, as at the end of December 2019.

1.2 To update Cabinet on the impact upon the approved capital programme for 2020/21 – 2024/25. The current estimate is a decrease in spend in 2019/20 of £4.082million and an increase in spend in future years of £3.831million. The most significant individual change relates to reprofiling the budget for Providing Housing at Market Rents.

1.3 To inform Cabinet of the Treasury Management activities in the first nine months of 2019/20. The current forecast is that the amount of investment interest expected to be generated during the year is £0.418million. This is an increase of £0.046M from the value reported at the second quarter.

2. RECOMMENDATIONS

2.1 That Cabinet notes the forecast expenditure of **£1.804million** in 2019/20 on the capital programme, paragraph 8.2 refers.

2.2 That Cabinet approves the adjustments to the capital programme for 2019/20 onwards as a result of the revised timetable of schemes detailed in table 2, increasing the estimated spend in 2020/21 and beyond by **£3.831million.**

2.3 That Cabinet notes the position of the availability of capital resources, as detailed in table 3 paragraph 8.6 and the requirement to keep the capital programme under review for affordability.

2.4 Cabinet is asked to note the position of Treasury Management activity as at the end of December 2019.

3. REASONS FOR RECOMMENDATIONS

3.1 Cabinet is required to approve adjustments to the capital programme and ensure the capital programme is fully funded.

3.2 To ensure the Council's continued compliance with CIPFA's code of practice on Treasury Management and the Local Government Act 2003 and that the Council manages its exposure to interest and capital risk.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 Options for capital investment are considered as part of the Corporate Business Planning process.

4.2 The primary principles governing the Council's investment criteria are the security of its investments (ensuring that it gets the capital invested back) and liquidity of investments (being able to get the funds back when needed). After this the return (or yield) is then considered, which provides an income source for the Council. In relation to this the Council could take a different view on its appetite for risk, which would be reflected in the Investment Strategy. In general, greater returns can be achieved by taking on greater risk. Once the Strategy has been set for the year, there is limited scope for alternative options as Officers will seek the best return that is in accordance with the Investment Strategy.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

5.1 Consultation on the capital expenditure report is not required. Members will be aware that consultation is incorporated into project plans of individual capital schemes as they are progressed.

5.2 There are quarterly updates with the Authority's Cash Manager, Tradition and regular meetings with Treasury advisors (Link).

6. FORWARD PLAN

6.1 This report contains a recommendation on a key Executive decision that was first notified to the public in the Forward Plan on the 6th December 2019.

7. BACKGROUND

7.1 In February 2019, Council approved the Integrated Capital and Treasury Strategy for 2019/20 to 2022/23. This was a change from having a separate Capital Programme and Treasury Strategy. The change was in response to guidance from the Ministry for Housing, Communities and Local Government (MHCLG) and the Chartered Institute of Public Finance and Accountancy (CIPFA). To be consistent with the strategy (and the guidance), the monitoring reports for Capital and Treasury are also integrated.

7.2 The Medium Term Financial Strategy for 2019 to 2024 confirmed that the Council will seek opportunities to utilise capital funding (including set aside receipts) for 'invest to save' schemes and proposals that generate higher rates of return than standard treasury investments. This is one way the Council will allocate resources to support organisational transformation that will reduce revenue expenditure.

7.3 Link Asset Services Ltd were first contracted to provide Treasury advice for the financial year 2012/13 and this arrangement has been extended until 2022/23. The service includes:

- Regular updates on economic and political changes which may impact on the Council's borrowing and investment strategies
- Information on investment counterparty creditworthiness
- Technical updates
- Access to a Technical Advisory Group.

8. RELEVANT CONSIDERATIONS

8.1 The Council has £114.5 million of capital assets that it currently owns. This is unchanged from the second quarter report. The Investment Strategy set out the reasons for owning assets that are not for service delivery, including an assessment of Security, Liquidity, Yield and Fair Value. There have been no changes in relation to these since the Strategy was set.

Capital Programme 2019/20

8.2 The full capital programme is detailed in Appendix A and shows the revised costs to date, together with the expected spend from 2019/20 to 2022/23 and the funding source for each capital scheme.

8.3 Capital expenditure for 2019/20 is estimated to be **£1.804million**. This is a reduction of **£4.082million** on the forecast in the Mid-Year Review report (reported to Cabinet on 17th December2019). The decrease in spend in 2019/20 is largely due to the reprofiling of projects into 20/21.Table 1 below details changes to capital programme.

Table 1- Current Capital Estimates

	2019/20 £M	**2020/21 £M**	**2021/22 to 2024/25 £M**
Original Estimates approved by Full Council February 2019	**8.213**	**0.962**	[redacted]
Changes approved by Cabinet in 2018/19 Capital Outturn report	1.007	0	[redacted]
Revised Capital estimates at start of 2019/20	**9.220**	**0.962**	[redacted]
Changes at Q1	-1.398	1.408	[redacted]
Changes at Q2	-1.936	1.450	[redacted]
Changes in 20/21 strategy approved by full Council in February	0	5.507	[redacted]
Changes at Q3 detailed in this report	-4.082	3.831	[redacted]
Current Capital Estimates	**1.804**	**13.158**	**23.524**

8.4 Table 2 lists the schemes in the 2019/20 Capital Programme that will start or continue in 2020/21:

Table 2: Scheme Timetable Revision:
(Key: - = reduction in capital expenditure, + = increase in capital expenditure)

Scheme	2019/20 Working Budget £'000	2019/20 Forecast Spend £'000	Difference £'000	Reason for Difference	Estimated impact on 2020/21 onwards £'000
Cycle Strategy Implementation	278	0	-278	Work has commenced and meetings have been held with stakeholders regarding these projects and will be progressed in more detail in 20/21 in line with the Local Plan.	278
Transport Plans Implementation	250	0	-250	Work has commenced and meetings have been held with stakeholders regarding these projects and will be progressed in more detail in 20/21 in line with the Local Plan.	250
Install On Street Charging	50	0	-50	Work on this will follow the adoption of the Parking Strategy Operational Guidelines by Cabinet in March 2020.	50
Property Improvements	79	25	-54	Due to the value limit for items to be capitalised and there being a limited number of significant capital replacements being identified during the year, there has been less demand on this capital budget during the year.	54
Off Street Car Parks Resurfacing	30	0	-30	Works to resurface Hitchin Outdoor Pool Car Park will commence in the summer, so it is requested that the budget is reprofiled into 2020/21.	30
Sprung Floor Hitchin Town Hall	75	0	-75	The wood used on the current floor has been identified as a rare and protected wood. Furthermore, wooden flooring boards are no longer milled to the same width and length as the current floor. We are therefore liaising with Planning officers to understand how closely these specifications need to	75

Scheme	2019/20 Working Budget £'000	2019/20 Forecast Spend £'000	Difference £'000	Reason for Difference	Estimated impact on 2020/21 onwards £'000
				be matched to satisfy the requirements of the listed building.	
NH Museum & Community Facility	70	14	-56	The overall museum facility has opened to the public and recently the Terrace Area has been furnished and decorated. Officers have now installed an attractive outdoor seating area, which has helped to create an additional hireable events space for the Council to create additional revenue. In order for this area to have year round use and maximise income, the intention is to install a canopy structure, shielding this outdoor seating area from adverse weather conditions. A structure of this sort of permanence will require both planning permission and listed building consent which has resulted in full completion of the area moving into 2020/21.	56
Provide Housing at Market Rents	2,982	5	-2,977	There has been delays in undertaking work at Harkness Court, therefore, this work will now commence in 2020/21. Officers are still exploring the viability of a property letting company and until this work has been approved this budget will not be spent.	2,977
Total Minor (under £25k) slippage on other projects	466	0	-62		62
Total Revision to Budget Profile			**-3,832**		**3,832**

8.5 There are also changes to the overall costs of schemes in 2019/20. These changes total a net decrease of £0.251million and are detailed in Table 3.

<u>Table 3: Changes to Capital Schemes Commencing in 2019/20</u>:
(Key: - = reduction in capital expenditure, + = increase in capital expenditure)

Scheme	**2019/20 Working Budget £'000**	**2019/20 Forecast Spend £'000**	**Difference £'000**	**Comments**
Renovate King George V Recreation Ground Play Area	75	34	-41	At the initial site inspection, it was identified that only a limited number of items required updating or replacement.
Leisure Condition Survey	0	30	30	The £64K budget was previously reprofiled to 20/21 but it is now possible to commence the roof repairs at the Letchworth Outdoor Pool in March and finish in April 2020. Therefore, some of the spend will be in 2019/20.
On Street Pay and Display Charging	235	0	-235	This has been reassigned as part of the Budget Setting process for 2020/21 and is recorded as NCP46 in the Capital Investment Proposals approved by Full Council on 6 Feb.
		Other minor changes	**-5**	
		Total revision to scheme spend	**-251**	

Capital Programme 2019/20 Funding onwards

8.6 Table 3 below shows how the Council will fund the 2019/20 capital programme.

<u>Table 3: Funding the Capital Programme</u>:

	2019/20 Balance at 1st start of year £M	**2019/20 Estimated Additions £M**	**2019/20 Funding Used £M**	**2019/20 Balance at end of year £M**
Useable Capital Receipts and Set-aside Receipts	8.490	0.474	(1.396)	7.568
IT Reserve			(0.005)	
S106 receipts			(0.248)	
Other third party grants and contributions			(0.155)	
Total	**8.490**		**(1.804)**	

8.7 The availability of third party contributions and grants to fund capital investment is continuously sought in order to reduce pressure on the Council's available capital receipts and allow for further investment. Additional capital receipts are dependent on selling surplus land and buildings. Ensuring that the Council gets best value from the disposal of land and buildings can take a long time and therefore the amounts that might be received could be subject to change. This will be kept under review throughout the year. No substantial funds from land sales are forecast until 2021/22.

8.8 The Council's Capital Financing Requirement at 31st March 2019 was negative £5.9 million. Based on current forecasts it is expected to remain negative during 2019/20, which means that the Council does not have a need to borrow to fund capital spend. However, should the Capital programme be fully spent in 20/21 there will be a potential need to borrow £4.0M which will have an impact on the General fund by way of a Minimum Revenue Provision (MRP). This need to borrow will mainly be dependent on spend in line with the property acquisition and development strategy. It is expected that any such spend will generate income that will exceed the cost of capital (interest costs and Minimum Revenue Provision).

Treasury Management 2019/20

8.9 Whilst the Council does not have a need to borrow for capital spend in this financial year, it still holds historic borrowing that is uneconomical to repay early. Borrowing can also be used for short-term cashflow purposes. During the first nine months no long-term borrowing was taken out and no historic borrowing became due for repayment.

8.10 The Council invests its surplus cash in accordance with the Investment Strategy (see paragraph 4.2). This surplus cash is made up of capital funding balances, revenue general fund balance, revenue reserve balances and variations in cash due to the timing of receipts and payments. During the first nine months, the Council had an average investment balance of £38.9 million and invested this in accordance with the treasury and prudential indicators as set out in the Integrated Capital and Treasury Management Strategy and in compliance with the Treasury Management Practices. Officers can confirm that the approved investment limits within the Annual Investment Strategy were not breached during the quarter ended 31 December 2019. However, the Council's current account did exceed the £5M maximum limit on 15 October by £400K for two days. This occurred as the Housing Subsidy payment received from DWP was £1.1M higher than expected. The increased amount was in respect of the Subsidy being adjusted to reflect figures supplied in the NNDR3 claim. Officers will ensure that this annual change to the Housing Subsidy will in future be identified as early as possible and included in cashflow forecasts. The adjusted Housing Subsidy payment could be an increase or a decrease. The £5M limit was also exceeded on 4 December by £43K when £91K was unexpectedly received in the afternoon after the cut off time for deals had passed.

8.11 The Council generated £0.303 million of interest during the first nine months of 2019/20. The average interest rate on all outstanding investments at the 31 December was 1.11%. Based on current investments and forecasts of interest rates and cash balances for the remainder of the year, it is forecast that the Council will generate £0.418 million of interest over the whole of 2019/20.

8.12 As at 31 December the split of investments was as shown in the table below. 5% of total investments (and 19% of the total amount invested in banks) were non-UK banks:

Banks	29%
Building Societies	30%
Local Authorities	39%
Money Market Funds	2%

8.13 The level of risk of any investment will be affected by the riskiness of the institution where it is invested and the period that it is invested for. Where an institution has a credit rating this can be used to measure its riskiness. This can be combined with the period remaining on the investment to give a historic risk of default percentage measure. The table below shows the Historic Risk of Default for outstanding investments at 31 December. The most risky investment still has a historic risk of default of below 1%. It should also be noted that in general the interest rate received is correlated to the risk, so the interest income received would be less if it took on less risk. As stated in paragraph 8.10, all investments have been made in accordance with the Investment Strategy.

Borrower	**Principal Invested £M**	**Interest Rate %**	**Credit Rating**	**Days to Maturity at 31 Dec**	**Historic Risk of Default %**
Public Sector Deposit Fund	1.0	0.72 Variable	AAA	1	0.000
Darlington Blsg Soc	1.0	1.3	*	9	0.004
Yorkshire Bldg Soc	1.0	0.69	A-	12	0.002
Santander UK Bank	2.0	0.8	A+	14	0.002
Australia and New Zealand Bank	1.0	0.81	AA-	19	0.001
Bank of Scotland	1.0	0.81	A+	19	0.003
Principality	1.0	0.75	BBB	19	0.008
Coventry Bldg Soc	1.0	0.99	A-	47	0.007
Yorkshire Bldg Soc	1.0	0.96	A-	47	0.007
Surrey Heath Borough Council	3.0	0.75	AA	49	0.003
Wirral Metropolitan Borough Council	3.0	0.75	AA	49	0.003
Lloyds Bank	1.0	1.05	A+	63	0.009
Santander UK	1.0	0.83	A+	76	0.011
Bank of Scotland	1.0	0.75	A+	76	0.011
Lancashire County Council	1.0	1.1	AA	78	0.005
Australia and New Zealand Bank	1.5	0.79	AA-	78	0.005
Derbyshire County Council	3.0	0.9	AA	89	0.006
Hinckley & Rugby Bldg Soc	2.0	1.35	*	114	0.050
Skipton Bldg Soc	1.0	0.92	A-	119	0.050
Dudley Bldg Soc	1.0	1.3	*	127	0.056
Merthyr Tydfil County Borough Council	1.0	0.85	AA	148	0.010
Furness Bldg Soc	1.0	1.3	*	153	0.067

London Borough of Sutton	2.0	0.8	AA	156	0.010
Lloyds Bank	1.0	1.25	A+	215	0.031
North Lanarkshire Council	3.0	0.9	AA	253	0.017
Lloyds Bank	1.0	1.1	A+	309	0.045
Medway Council	2.0	1.25	AA	310	0.021
Newcastle Bldg Soc	1.0	1.17	*	331	0.145
Marsden Bldg Soc	1.5	1.6	*	387	0.467
Monmouthshire Bldg Soc	1.0	1.5	*	513	0.618
	43.0	1.11			

* Unrated Building Societies Historic Risk of Default is based on a Fitch (a credit rating agency) rating of BBB.

9. LEGAL IMPLICATIONS

9.1 Cabinet's terms of reference under 5.6.7 specifically includes "to monitor expenditure on the capital programme and agree adjustments within the overall budgetary framework". The Cabinet also has a responsibility to keep under review the budget of the Council and any other matter having substantial implications for the financial resources of the Council. By considering monitoring reports throughout the financial year Cabinet is able to make informed recommendations on the budget to Council. The Council is under a duty to maintain a balanced budget.

9.2 Section 151 of the Local Government Act 1972 states that:
"every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."

9.3 Asset disposals must be handled in accordance with the Council's Contract Procurement Rules.

10. FINANCIAL IMPLICATIONS

10.1 The main financial implications are covered in section 8 of the report.

10.2 The Authority operates a tolerance limit on capital projects that depends on the value of the scheme and on this basis over the duration of the programme it should be anticipated that the total spend over the period could be around £3.653million higher than the estimated budget of £38.486million.

10.3 The capital programme will need to remain under close review due to the limited availability of capital resources and the affordability in the general fund of the cost of using the Council's capital receipts. When capital receipts are used and not replaced the availability of cash for investment reduces. Consequently interest income from investments reduces. £1.0million currently earns the Authority approximately £1.0k a year in interest. The general fund estimates are routinely updated to reflect the reduced income from investments. When the Capital Financing Requirement (CFR) reaches zero the Council will need to start charging a minimum revenue provision to the general fund for the cost of capital and will need to consider external borrowing for further capital spend. The CFR at the 31 March 2019 was negative £6million.

10.4 The Council also aims to ensure that the level of planned capital spending in any one-year matches the capacity of the organisation to deliver the schemes to ensure that the impact on the revenue budget of loss of cash-flow investment income is minimised.

11. RISK IMPLICATIONS

11.1 The inherent risks in undertaking a capital project are managed by the project manager of each individual scheme. These are recorded on a project risk log which will be considered by the Project Board (if applicable). The key risks arising from the project may be recorded on Pentana (the Council's Performance & Risk management software). Some of the major capital projects have been included in the Council's Corporate Risks (such as the new North Hertfordshire Museum). The Corporate Risks are monitored by the Finance, Audit and Risk Committee and Cabinet.

11.2 Risks associated with treasury management and procedures to minimise risk are outlined in the Treasury Management Practices document, TMP1, which was adopted by Cabinet in July 2003 and is revisited annually as part of the Treasury Strategy review. The risk on the General Fund of a fall of investment interest below the budgeted level is dependant on banks and building societies need for borrowing.

12. EQUALITIES IMPLICATIONS

12.1. In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.

12.2 There are no direct equalities implications directly arising from the adoption of the Capital Programme for 2019/20 onwards. For any individual new capital investment proposal of £50k or more, or affecting more than two wards, an equality analysis is required to be carried out. This will take place following agreement of the investment proposal.

13. SOCIAL VALUE IMPLICATIONS

13.1. The Social Value Act and "go local" requirements do not apply to this report.

14. HUMAN RESOURCE IMPLICATIONS

14.1 There are no direct human resource implications.*no impact.*

15. APPENDICES

15.1 Appendix A - Capital Programme Detail including Funding 2019/20 onwards.

15.2 Appendix B - Treasury Management Update

16. CONTACT OFFICERS

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17. BACKGROUND PAPERS

17.1 Investment Strategy (Integrated Capital and Treasury Strategy) https://democracy.north-herts.gov.uk/documents/s4263/Appendix%20A-%20Investment%20Strategy.pdf