FINANCE, AUDIT AND RISK COMMITTEE
15 JUNE 2020

***PART 1 – PUBLIC DOCUMENT**

TITLE OF REPORT: INVESTMENT STRATEGY (CAPITAL AND TREASURY) END OF YEAR 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 As at the end of financial year 2019/20, there is a reduction in Capital spend compared to quarter 3 of **£0.331million**. The majority of this change is due to revisions to the profile of planned project spend, with **£0.277million** that will now instead be incurred in 2020/21.

1.2 During the year the Council has generated **£0.411million** of interest from its investments. This is slightly below the budgeted total of £0.418million. The Council continued to invest in smaller Building Societies (subject to checks that compare the size of the Society with that of the investment) and also now invests in non-UK banks.

1.3 The Council has repaid £0.017million of borrowing during the year as it has matured. The Council has £0.423million of remaining borrowing. This borrowing is at a fixed rate for a fixed period. The premium incurred from repaying this borrowing early means that it is not worthwhile to do so.

1.4 The Council complied with its legislative and regulatory requirements throughout the year.

1.5 The forecast for 2020/21 is that investment income will continue to reduce due to market conditions, the use of cash balances to fund the capital programme and the effect of Covid-19.

2 RECOMMENDATIONS

2.1 That Cabinet notes expenditure of **£1.473million** in 2019/20 on the capital programme, paragraph 8.3 refers, and in particular the changes detailed in table 3 which resulted in a net decrease on the working estimate of **£0.055million**.

2.2 That Cabinet approves the adjustments to the capital programme for 2020/21 as a result of the revised timetable of schemes detailed in table 2, increasing the estimated spend in 2020/21 by **£0.277million** (re-profiled from 2019/20).

2.3 That Cabinet notes the position of the availability of capital resources, as detailed in table 4 paragraph 8.6 and the requirement to keep the capital programme under review for affordability.

2.4 That Cabinet approves the application of **£0.639million** of capital receipts towards the 2019/20 capital programme and the drawdown of £0.397million from set aside receipts, paragraph 8.6 refers.

2.5 Cabinet is asked to note the position of Treasury Management activity as at the end of March 2020.

2.6 Cabinet is asked to recommend this report to Council and ask Council to:

1) Approve the actual 2019/20 prudential and treasury indicators.
2) Note the annual Treasury Report for 2019/20.

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 13th March 2020.

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 £117.0 million of capital assets that it currently owns. This has increased from £114.5 million as at 31 March 2019. 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 The outturn Capital expenditure for 2019/20 is **£1.473million**. This is a reduction of **£0.331million** on that reported at the end of the third quarter. The decrease in spend is largely due to re-profiling spend into future years and underspend on projects. Table 1 below details the changes from what was reported at Quarter 3.

<u>Table 1- Current Capital Estimates</u>

	2019/20 £M	2020/21 £M	2021/22 to 2024/25 £M
Original Estimates approved by Full Council February 2019	**8.213**	**0.962**	
Changes approved by Cabinet in 2018/19 Capital Outturn report	1.007	0	

	2019/20 £M	2020/21 £M	2021/22 to 2024/25 £M
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	-4.082	3.831	[redacted]
Changes since Q3	-0.331	0.277	
Outturn 2019/20	**1.473**	**13.435**	**23.524**

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

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

Scheme	2019/20 Working Budget £'000	2019/20 Outturn £'000	Difference £'000	Reason for Difference	Estimated impact on 2020/21 onwards £'000
Community Facilities Refurbishment	313	210	-103	Community facilities are run with minimal resource to service the needs of the building. Many facilities are solely supported by volunteers. Officers have found that these committees are often under-resourced to complete any additional work over and above the maintenance of the building, taking bookings and other general up-keep of a facility. The completion of applications has, therefore, taken more time than anticipated since the inception of the grant scheme.	103

Scheme	2019/20 Working Budget £'000	2019/20 Outturn £'000	Difference £'000	Reason for Difference	Estimated impact on 2020/21 onwards £'000
Baldock Town Hall Improvements	70	21	-49	This project is demand led and spend is dependent on invoices being submitted for payment once works have been completed.	49
Cyber Attacks	30	0	-30	The pre-planned Cyber Essentials training and procurement of new hardware was put back due to a delay in the annual Penetration Test being carried out. The results of the test will contain recommendations for any new hardware required.	30
Leisure Condition Survey	30	0	-30	Works were originally programmed in 20/21 but an opportunity arose to bring the work forward to 19/20. However, only one formal price was received from contractors and, as this did not comply with our contract procurement rules, the work was unable to commence before the end of March.	30
Total Minor (under £25k) slippage on other projects			-65		65
Total Revision to Budget Profile			**-277**		**277**

8.5 There are also changes to the overall costs of schemes in 2019/20. These changes total a net decrease of £0.055million and are detailed in Table 3.

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

Scheme	2019/20 Working Budget £'000	2019/20 Forecast Spend £'000	Difference £'000	Comments
Home Repair Assistance	60	21	-39	Spend on this budget is demand led. All applications received during the year were actioned. Some have taken longer to process due to resourcing issues and some have been delayed by the request of the applicant. £15K income offset the spend as previously award grant funding was returned as per the terms of the grant agreements.
Other minor changes			**-16**	
Total revision to scheme spend			**-55**	

8.6 The following capital schemes have been completed during 2019/20:

- Channel Shift - Housing Register
- Museum / Town Hall Lift
- Acoustic Panelling Hitchin Town Hall
- Bar Facility Hitchin Town Hall
- Letchworth Outdoor Pool Safety
- Auto Chemical Dosing Pumps
- Renovate District Park Great Ashby
- Renovate King George V Play Area
- Various IT Projects

Capital Programme 2019/20 Funding onwards

8.7 Table 4 below shows how the Council will fund the 2019/20 capital programme.

<u>Table 4: Funding the Capital Programme</u>:

	2019/20 Balance at start of year £M	**2019/20 Additions £M**	**2019/20 Funding Used £M**	**2019/20 Balance at end of year £M**
Useable Capital Receipts and Set-aside Receipts	8.490	0.0	(1.036)	7.454
IT Reserve		[redacted]	(0.005)	
S106 receipts	[redacted]	[redacted]	(0.346)	[redacted]
Other third party grants and contributions	[redacted]	[redacted]	(0.083)	[redacted]
Revenue contributions	[redacted]	[redacted]	(0.003)	[redacted]
Total	**8.490**		**(1.473)**	

8.8 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.

8.9 The Council's Capital Financing Requirement (CFR) at 31st March 2020 was negative £5.60 million (negative £5.99 million 31st March 2019). As the CFR is negative 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

8.10 In summary, the Council has operated both within the treasury and prudential indicators set out in the Treasury Management Strategy Statement and in compliance with the Treasury Management Practices. The £5 million limit on the Council's current account was exceeded on two separate occasions and each was reported to Members in the quarterly monitoring reports.

8.11 The Council generated £0.411M of interest during 2019/20. The average interest rate agreed on new deals during the year was 0.99%. The average interest rate on all outstanding investments at the 31st March was 1.18%.

8.12 The Council's activities expose it to a variety of risks (credit, liquidity and market). The Treasury Strategy sets out the Authority's appetite for the level of exposure to these risks.

8.13 **Security Risk** – The possibility that other parties fail to pay amounts due to the Authority.

The Council's counterparty list comprises UK building societies and UK banks with a Fitch (a credit rating agency) credit rating greater than BBB, non-UK banks with a credit rating greater than AA- with a AAA Country rating, but also includes other Local Authorities and Public Corporations. It also includes smaller Building Societies that do not have a credit rating.

8.14 **Liquidity Risk** – the possibility that the Authority may not have funds available to meet its commitments to make payments.

8.15 **Market Risk** - the possibility that financial loss might arise as a result of changes in interest rates.

Investing long term (greater than one year) currently achieves higher interest rates than short term deals. The risks of long term deals are:

(i) The longer the time period the longer the investment is exposed to default.
(ii) If the investment has a fixed interest rate, interest rates could rise and the potential to invest at a higher rate will be lost until the investment matures.

8.16 Members have indicated that they are prepared to accept this risk within the limits expressed in the Treasury Strategy, which allows no more than 12M of outstanding investments to be invested for longer than 365 days at any one time. At the end of the year the Council had £1.0M (3.4%) invested for longer than 365 days.

8.17 **Interest (Yield)** - This year has continued to prove challenging to find counterparties willing to pay a reasonable return on cash investments, either long or short term. The uncertainty around interest rate changes has continued in 19/20, with the latest predictions indicating that there will be no increase in base rate during 2020/21.

8.18 The investments outstanding at the 31 March 2020 were £37.5million. This compares to a balance of £32.4million at 31 March 2019. These figures include the balance on the interest-bearing current account. Investment in capital projects will continue during 2020/21 and combined with declining returns for new investments, means that the estimated investment interest for 2020/21 was set at £0.300million. This was set, however, prior to a further fall in interest rates and the outbreak of Covid-19. This figure is therefore expected to reduce and will be updated in the first monitoring report of 2020/21.

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.

9.4 The Prudential Indicators comply with the Local Government Act 2003.

10. FINANCIAL IMPLICATIONS

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

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 next ten-year programme it should be anticipated that the total spend over the period could be £4.022million higher than the originally budgeted £45.491million.

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 £10.0k 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 2020 was negative £5.6million.

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. ENVIRONMENTAL IMPLICATIONS

14.1. There are no known Environmental impacts or requirements that apply to recommendations of this report. The projects at section 8.4 may have impacts that contribute to an adverse impact. As these projects go forward, an assessment will be made where necessary.

15. HUMAN RESOURCE IMPLICATIONS

15.1 There are no direct human resource implications.

16. APPENDICES

16.1 Appendix A, Capital Programme Detail including Funding 2019/20 onwards.
Appendix B, Treasury Management Annual Review.

17. 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