

CABINET
28 January 2020

***PART 1 – PUBLIC DOCUMENT**

TITLE OF REPORT: INVESTMENT STRATEGY (INTEGRATED CAPITAL AND TREASURY)

REPORT OF THE SERVICE DIRECTOR- RESOURCES

EXECUTIVE MEMBER FOR FINANCE AND IT

CURRENT COUNCIL PRIORITY: RESPONSIVE AND EFFICIENT

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

1. EXECUTIVE SUMMARY

1.1 The Investment Strategy provides the following key information:

- A capital programme of £9.357m in 2020/21 and £23.524m for the period 2021/22 to 2024/25.
- Recommendations on the Prudential and other Treasury indicators that will be monitored and reported on during the year (2020/21)
- As the Council has identified a need to borrow for capital purposes, a borrowing and Minimum Revenue Provision (MRP) policy
- The scope of treasury investments where the Council will invest any surplus cash.

2. RECOMMENDATIONS

2.1. That Cabinet recommend to Council the adoption of the Investment Strategy (as attached at Appendix A), including the capital programme and prudential indicators.

2.2. That Cabinet recommend to Council the adoption of the four clauses in relation to the Code of Practice on Treasury Management (as detailed in paragraphs 8.11 to 8.16).

3. REASONS FOR RECOMMENDATIONS

3.1 To ensure that the capital programme meets the Council's objectives and officers can plan the implementation of the approved schemes.

3.2 To ensure the Council's compliance with CIPFA's code of practice on Treasury Management, the Local Government Act 2003, statutory guidance from the Ministry of Housing, Communities and Local Government and the CIPFA Prudential Code. As well as determining and managing the Councils risk appetite in respect of investments.

4. ALTERNATIVE OPTIONS CONSIDERED

- 4.1 Each proposed capital scheme is the result of consideration of options for continuous service improvement by the relevant Service Director in consultation with the relevant Executive Member.
- 4.2 The primary principle governing the Council's investment criteria is the security and liquidity of its investments. After this the return (or yield) is then considered, which provides an income source for the Council. In general, greater returns can be achieved by taking on greater risk.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

- 5.1 All Members were given opportunity to comment on all new Capital investment proposals, as well as existing projects earmarked in future years, at the Member Budget Workshops held in November 2019. Notes of the comments and questions raised at the workshops were provided to Cabinet in December.
- 5.2 Members will be aware that consultation is incorporated into project plans of individual capital schemes as they are progressed.
- 5.3 There is ongoing dialogue with the Authority's Cash Manager, Tradition and regular meetings with Treasury advisors (Link).

6. FORWARD PLAN

- 6.1 This report does not contain a recommendation on a key Executive decision, as the ultimate decision is made by Full Council. However it has been included on the Forward Plan and was first notified to the public on 11 October 2019. This was on the basis that there could have been an Executive decision required.

7. BACKGROUND

- 7.1 The Corporate Business Planning Process begins each year with consideration of policy priorities and the Council's Priorities for the District and a review of the Medium Term Financial Strategy. Finance and other resources are aligned to the strategic priorities as set out in the Council Plan.
- 7.2 Cabinet receives quarterly updates on the delivery and funding of the Council's capital programme, with the report presented at the December meeting of Cabinet providing estimates as at the end of the second quarter of 2019/20. The report advised that total expenditure of £11.881m would be required to deliver the current capital programme for 2019-2024, with £5.886m forecast to be spent in 2019/20. Table 1 below details the changes to the existing capital programme reported to Cabinet since the Capital Programme was approved by Full Council in February 2019.

Table 1

	2019/20 £m	2020/21 £m	2021/22 to 2023/24 £m
Original Estimate approved by Full Council February 2019	8.213	0.962	2.128
Changes approved by Cabinet in 2018/19 Capital Outturn Report	1.007	0	0
Changes approved by Cabinet at 1 st Quarter	-1.398	1.408	0
Changes approved by Cabinet at 2 nd Quarter	-1.936	1.450	0.047
Current Capital Estimates	5.886	3.820	2.175

7.3 Members were given opportunity to comment on all new Capital investment proposals, as well as existing projects earmarked in future years, at the Member Budget Workshops held in November 2019. Notes of the comments and questions raised at the workshops were provided to Cabinet in December.

7.4 The Treasury Strategy Statement for 2019/20 was approved by Council in February 2019. A mid year review of the Treasury Strategy was provided to Council in January 2020. There have been no changes made to the Strategy during the course of 2019/20.

8. RELEVANT CONSIDERATIONS

8.1 The proposed Investment Strategy is attached at Appendix A. Council are asked to approve this strategy, which includes the following:

- New capital investment proposals totalling £32.945m
- A total capital programme for the period of 2020/21 to 2024/25 of £32.881m.
- Adoption of a treasury strategy that covers borrowing and investment forecasts and limits, including prudential indicators

8.2 The following are provided as appendices to Investment Strategy, and are also appendices to this report:

- Appendix A1- A full list of planned future capital expenditure (2020/21 onwards)
- Appendix A2- A list of new capital schemes and schemes planned to commence from 2020/21

8.3 The format of the Investment Strategy is described in the introduction section (pages 2 and 3). The following sections highlight the significant considerations in relation to this version of the Strategy.

- 8.4 As detailed in table 7 on page 14, there is an allocation of £20m that is aligned to the Property Acquisition and Development Strategy. In addition, there is an allocation of £3m for spend on residential property that is funded from capital reserves and programmed in 2019/20. This is likely to slip into 2020/21 and will be reported in the third quarter monitoring report. Tables 8 (on page 16) provide an assessment of the Security, Liquidity and Yield of the projected spend on these assets. Table 9 (on page 16) details that the assessment of the expected risk of loss will be carried out as part of individual business cases.
- 8.5 As detailed in table 11 (on page 17) based on forecasts of capital receipts and spend, the Council will have a need to borrow to fund the capital programme. This will require £3.8m of borrowing in 2020/21, rising to £4.9m in 2023/24, £11.5m in 2024/25 and up to £20.0m by the end of 2029/30. As detailed on page 19, the Council can consider whether to borrow internally or externally. The advantages and disadvantages of each are also considered on pages 19 and 20. Based on this, and the uncertainty over value and timing of capital receipts it is considered that the Council should assume that it will need to borrow externally. This will be given further consideration at the time that any borrowing is needed. If the forecast is that the need is more likely to just be for a short period (e.g. there is greater certainty over capital receipts) or there is a clearer indication over future interest rates (e.g. they are not likely to rise) then internal borrowing will be reconsidered. It is also possible that there will not be the need to borrow that is identified if there is slippage on the capital programme, this is particularly likely in relation to the investments described in paragraph 8.4 above as they are dependent on there being the right opportunities.
- 8.6 Where the Council has a need to borrow then it incurs a revenue charge known as a Minimum Revenue Provision (MRP). For external borrowing there is also a need to pay interest costs. The need to borrow in effect comes from the decision that has been made to invest £20m in line with the Property Acquisition and Development Strategy. The primary reason for any such investment is for the purposes of its functions or the benefit, improvement or development of its area. However investments will only be taken forward if they generate a return of 1.5% above the greater of the actual or notional cost of capital (to calculate an assumed cost of MRP and interest to reflect opportunity cost where it is actually funded from capital reserves). This reflects suitable compensation for the risks of property investment. This return has not been factored in the revenue budgets and nor will the costs of capital (interest charges and MRP). This is considered to be a prudent net approach to take. The totals for Treasury Indicator 6 on page 24 are based on existing investment assets and spend in line with the capital programme on residential property and investments in line with the Property Acquisition and Development Strategy. The annual income is based on forecasts for the existing investments and an assumed return of 7% for new investments (2.5% MRP + 3% interest + 1.5% margin). The loans are in accordance with the identified need to borrow and the cost of borrowing is assumed at 5.5% (2.5% MRP and 3% interest).

- 8.7 As detailed on page 25, as the Council has a borrowing requirement, it needs to determine a MRP policy. The current capital programme is a combination of spend on service provision and investments that should generate a consistent return over time. Therefore it is considered appropriate to use adopt an equal instalment MRP policy. This can be reviewed in future if the Council ever looked at an investment with a return profile that increased over the life of the asset.
- 8.8 Table 17 on page 29 details where the Council can invest its surplus cash. This sets limits to ensure appropriate diversification. The following changes are proposed compared to last year:
- Last year there was a combined limit of 60% for Building Societies and Property Funds. Property Funds are generally exposed to commercial property and Building Societies to residential property. Therefore it is proposed to remove this link.
 - Instead Building Societies will be linked to the capital allocation for investment in residential properties, and this will be limited to 60% of the total available funds. Note that the total available funds are made up of the cash balances (as detailed in table 15 on page 26) plus the £3m for residential properties.
 - Given the uncertainty over the actual amount that will be invested in line with the Property Acquisition and Development Strategy, this total is not included within this table. It is also considered that the Strategy itself and each business case will help to ensure that there is cumulative diversification in this investment. The nature of the legal powers available for such investment will generally limit the focus to North Hertfordshire and the surrounding area. An investment in a property fund (as a treasury investment) will have much wider diversification in terms of number of properties, type of properties and location of properties. It is therefore not considered to create a direct linkage between a property fund and capital spend through the Property Acquisition and Development Strategy. However it is considered appropriate to limit investments in UK property funds to 10% in any one fund (or combination of funds).
 - To add the option to invest in Ultra-Short Dated Bond Funds. These funds invest in fixed income instruments with very short maturity dates, usually up to one year. This generally provides better returns than money market funds. Whilst this does introduce some capital risk, this is minimised by the short-term nature of such investments. The proposal is that such investments make up a maximum of 10% of the total balance.
- 8.9 Within the investment market, the opportunity for 'green' investments is starting to emerge. These are offering returns that are similar to, or the same as, non-green alternatives for the same level of risk. Subject to these investments being compliant with other aspects of the treasury strategy, then these investments will be prioritised over non-green alternatives.
- 8.10 The Code of Practice on Treasury Management requires that a report be submitted to Full Council setting out four clauses which should be formally passed in order to approve adoption of the code. The four clauses are detailed below, including how they are met by the Council. As recommended by CIPFA, where appropriate these are included within the Council's Constitution and Financial Regulations.

- 8.11 Clause 1 relates to creating and maintaining a Policy and practices as a cornerstone for effective treasury management.
- 8.12 Full Council are asked to approve the adoption of the following Treasury Management Policy Statement, which is the same as in previous years:
- This organisation defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.
 - This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
 - This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.
- 8.13 The Council has adopted treasury management practices (TMPs) which set out how the Council will carry out, manage and control the achievement of the policy above in practice. These TMPs are substantially unchanged from last year and follow the recommendations contained within the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments are minor and do not result in any material deviation from the Code’s key principles. The TMPs are operationally focused and therefore the themes covered are detailed below, rather than providing the full document. Where relevant the detail is already covered in the Investment Strategy (e.g. approved instruments):
- TMP1- Risk Management
 - TMP2- Performance Measurement
 - TMP3- Decision making and analysis
 - TMP4- Approved instruments, methods and techniques
 - TMP5- Organisation, clarity and segregation of responsibilities, and dealing arrangements
 - TMP6- Reporting requirements and management information arrangements
 - TMP7- Budgeting accounting and audit arrangements
 - TMP8- Cash and cash-flow management
 - TMP9- Money laundering
 - TMP10- Staff training and qualifications
 - TMP11- Use of external service providers
 - TMP12- Corporate Governance
- 8.14 Clause 2 relates to the reporting on treasury activities. These are set out in the Investment Strategy on page 3.

- 8.15 Clause 3 relates to the delegation of responsibility for the implementation and regular monitoring of its treasury management policies. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet (Constitution 5.6.9) and for the execution and administration of treasury management decisions to the Service Director: Resources (Constitution 14.6.12 (a) (iii) and Financial Regulations section 13) who will act in accordance with the Council's policy statement and treasury management practices and the CIPFA Standard of Professional Practice on Treasury Management.
- 8.16 Clause 4 relates to the scrutiny of treasury management strategy and policies. The Council nominates the Finance, Audit and Risk Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies (Constitution 10.1.5 (c)).

9. LEGAL IMPLICATIONS

- 9.1 Full Council will decide the overall capital budget (Constitution 4.3) and approve the treasury management strategy statement (Constitution 4.4.1 (dd)).
- 9.2 Cabinet will recommend to Full Council the annual capital budget (Constitution 5.6.38) and treasury management strategy statement (Constitution 5.6.39).
- 9.3 The Finance, Audit and Risk Committee will consider the Council's policy in relation to Treasury Management and make recommendations on the Annual Treasury Management and Investment Strategy, and Treasury Management Code of Practice (Constitution 10.1.5 (c)).
- 9.4 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." That officer is the Service Director- Resources.
- 9.5 The proposed Prudential Indicators contained within the Investment Strategy comply with the Local Government Act 2003. The Investment Strategy has been developed to comply with the statutory guidance from the Ministry of Housing, Communities and Local Government and the CIPFA Prudential Code.

10. FINANCIAL IMPLICATIONS

- 10.1 These are covered in section 8.

11. RISK IMPLICATIONS

- 11.1 Capital investment is sometimes needed to mitigate against a risk to the Council. This is detailed to Members when a new investment comes forward. The risk implications of each individual scheme are considered in project plans as the schemes are progressed. The capital programme assumes a level of third party contributions and grants towards the cost of the schemes. There is a risk that not all the contributions are forthcoming.

- 11.2 Investment risks in relation to treasury management are covered in this report and the Investment Strategy. The TMPs (see 8.13) and Financial Regulations provide controls to manage other risks.

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 2020/21 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 resources implications arising from this report.

15. APPENDICES

- 15.1. Appendix A- Investment Strategy
15.2. Appendix A1- A full list of planned capital expenditure (2020/21 onwards)
15.3. Appendix A2- A list of new capital schemes and schemes planned to commence from 2020/21

16. CONTACT OFFICERS

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17. BACKGROUND PAPERS

- 17.1. None