CABINET - 19TH SEPTEMBER 2019

Report of the Director of Corporate Services
Lead Member: Councillor Barkley

Part A

ITEM 12 INVESTMENT STRATEGY

Purpose of Report

This report proposes an investment strategy that the Council would adopt for the remainder of financial year 2019/20 and the financial year 2020/21.

If adopted, the Investment Strategy would be incorporated within the overarching annual Capital Strategy, the first version of which was prepared and approved by a meeting of full Council on 25 February 2019.

As part of the budgetary and policy framework, adoption of this strategy will require approval by Council.

Recommendation

That it is recommended to Council that the proposals set out at Appendix B of this report are adopted and incorporated into the extant Capital Strategy.

Reason

To provide additional clarity to the extant Capital Strategy and enable the Council to increase the range of its investment activities.

Policy Justification and Previous Decisions

This decision supports the overall objective of delivering better services, by enabling the Council to make better use of its assets.

The overarching Capital Strategy, in which these investment strategy proposals would be incorporated, was approved by Council on 25 February 2019 (minute reference 77.2).

Implementation Timetable including Future Decisions and Scrutiny

The investment strategy will become extant once (and if) approved by Council. The next appropriate meeting of full Council would be 4 November 2019.

It is envisaged that this document will be scrutinised by the Corporate Services Scrutiny Committee at its meeting of 17 September 2019 and by the Scrutiny Commission should they select this report for Scrutiny.

Report Implications

The following implications have been identified for this report.

Financial Implications

Whilst approval of the Investment Strategy would enable the Council to undertake significant investment activity, this report does not of itself commit the Council to any financial transactions.

There are therefore no direct financial implications.

Risk Management

All significant investments enabled by this proposed strategy would be the subject of a separate Cabinet decision. There are therefore no direct risks associated with this report.

Key Decision:	Yes (reserved to Council)
Background Papers:	Capital Strategy – report to Council of 25 February 2019
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Part B – INVESTMENT STRATEGY

Background

Previous reports on this topic

1. The Council is now required to prepare an annual Capital Strategy. The first of these was prepared and approved by a meeting of full Council on 25 February 2019, to take effect from 1 April 2019[1].

2. This version of the strategy discussed Commercial Investment in broad terms and noted (Section 4) that a further report with firmer proposals would be brought forward subsequently; those proposals are contained within this report.

Scope of this report

3. This report covers treasury management and non-core activities undertaken primarily or partially to generate income and support the delivery of a balanced budget. Reference within the report is made to Housing Revenue Account activities but the focus of the report is on the General Fund, and the potential impact of commercial activities in the General Fund budget.

4. This report sets out:

   - The Council's existing custom and practice in respect of investment activities
   - Possible options available to the Council should a more proactive investment approach be deemed appropriate
   - Alternatives to investment – paying off existing loans and liabilities
   - Proposed investment strategy for the remainder of financial year 2019/20 and financial year 2020/21
   - Assumptions arising from the proposed investment strategy used for the construction of the Medium Term Financial Strategy 2020-2023 and the next iterations of the budget and capital plan.

Existing custom and practice

5. Historically, the Council's approach to investment of all types can be described as low-risk, or generally risk averse.

6. Since April 2018 the Council has had, at any point in time, between £36m and £60m invested in short term financial instruments, in accordance with its

[1] See https://charnwood.moderngov.co.uk/ieListDocuments.aspx?CId=138&MId=228

Treasury Management Strategy[2]. Much of this money does not actually belong to the Council; some, for example, is the share of council tax collections due to be paid over to the major preceptors, but it is apparent that this level of cash holding represents significant revenue generating opportunities. The precise mix and quantum of investment balances varies with the Council's cash flow, but generally the bulk of investment is in short or very short-term money market instruments with a smaller proportion invested in the form of loans to other local authorities for longer periods of up to two years. This approach to investment is prudent, both in terms of counter party risk, and liquidity (the ability to access investments and convert them to cash), but with a corresponding restriction on investment returns.

7. Recognising that investment returns from short term investment were low, the Council took the decision to invest up to £5m in Property Funds. Two funds were selected (Lothbury and Hermes) and the investments were placed in 2018. These investments were envisaged as being for the long term and with a view to achieving returns significantly above those available on the money markets. To date this (relatively small) element of the Council's overall investment portfolio has performed in line with expectations.

8. At the snapshot date of 31 March 2019, the Council had investments of some £50m, distributed as follows:

   - 'Specified investments' of £39m – being short term and very short term financial instruments; interest rates payable on these deposits are typically well below 1%, reflecting current bank base rates

   - Loans in other local authorities, accounting for £6m of treasury investments at 31 March 2019, which typically generate returns in the order of 0.7% - 1.4%, which are again a reflection of base rates

   - Property Funds in which £5m has been invested across two funds for the longer term, which are currently achieving their target return of around 6%.

   This activity generated income to the Council of £540,000 in 2018/19.

9. The Council also has a direct investment in properties in the Borough, comprising a portfolio of storage compounds, light industrial units and office accommodation which are let to business tenants at commercial rents. This is summarised at Appendix A. Occupation levels are generally good and overall the portfolio makes a positive return for the Council. However, the development of this portfolio has been somewhat piecemeal and can be attributed to historical or opportunistic factors rather than as being driven by an investment strategy.

[2] See Capital Strategy, Council 25 February 2019
http://intranet.charnwood.local/papers/council/20190225/Published%20Items/Cnl%2025%20February%202019%20Complete%20Agenda.pdf

10. Notwithstanding recent diversification of investment, in totality this portfolio can be viewed as being low-risk.

Existing approach to borrowing

11. The Council has taken on a significant amount of debt required to refinance the Housing Revenue Account, some £80m, arising from the government decision to abolish housing subsidy arrangements, but within the General Fund the Council carries only minimal debt of £2m relating to a very old loan taken out in 1984 and the Council has not exercised its ability to borrow within the General Fund since this date. This has not been necessary, as usable capital receipts and revenue funding has been sufficient to finance the Council's capital programme over this period.

12. Other local authorities have borrowed long-term money at low interest rates available from the Public Works Loan Board (recently around 3% depending on the term of the loan), to create property portfolio that generates a net return to the authority with an explicit purpose of providing financial support to the General Fund (thereby enabling a greater level of spending on services). This policy carries more risk than traditional investments in financial instruments but is designed to generate greater returns than would be available through the money markets. It is not a policy that the Council has followed to this point in time.

<u>Options</u>

13. There are a wide range of options that could be available to the Council if a more proactive approach to investment was considered. Most would require the Council accepting higher levels of risk in exchange for higher financial returns and/or facilitation of policy objectives (particularly those around regeneration or housing delivery). A range of these options – which in practice might be combined in hybrid arrangements - are outlined below:

1. Do nothing (continue with existing approach)

Continuing with the existing approach would be appropriate if the current investment portfolio, with its associated level of risk and return, is considered acceptable. However, opportunities to achieve higher levels of financial return or facilitate policy objectives may be missed. Generally, in an environment of financial scarcity continuation of the current approach may be viewed as unacceptably passive.

Positive aspects	*Negative aspects*
+ Known (low) portfolio risk + Acceptable level of financial return in relation to risk + No implementation costs	- Opportunities to increase financial returns may be missed - Opportunities to facilitate other policy objectives are foregone - Generally passive

2. Review Treasury Management Strategy to target higher financial returns

A relatively simple option would be to review the current protocols to target higher returns from the Council's treasury activities; recent initiatives along this line contributed to the Council generating £540,000 in 2018/19, versus £337,000 in the previous year. The extant Treasury Management Strategy does restrict the Council's actions to some extent, but the protocols embedded within this Strategy are partly self-imposed. Amendment of this Strategy could be implemented in line with the usual timetable and take effect from the 2020/21 financial year.

In practice adopting this Option would mean:

- Expanding the range of financial institutions with whom the Council would invest; at present the approved list is restricted to institutions with superior credit ratings
- Expanding the range of financial instruments within the Council would invest; for example, this could include investment in bonds with underlying assets in non-property assets such as renewable energy schemes, or portfolios of business loans through institutions such as Funding Circle
- Allowing investments to be placed for longer periods of time

In each case, this would mean accepting higher levels of risk and / or lower liquidity. The pros and cons of such an approach are tabulated below:

Positive aspects	*Negative aspects*
+ Higher financial returns achievable + Relatively easy to implement + Would use existing cash balances; no additional borrowing required	- Non-financial (policy) objectives are not addressed - Would probably require professional support for implementation and monitoring of investment portfolio - Higher risks have to be accepted

3. Proactive investment in property assets

Investment in property might be with the objective of:

- Maximising financial return
- Facilitation of policy objectives – such as delivery of affordable housing

At 31 March 2019 the Council had some £10.4m in usable capital receipts (funds available specifically for capital expenditure) and other revenue reserves that could be used to fund capital expenditure. Much of this funding is committed in the existing Capital Plan and it likely that any significant investment in property would need at least partial funding from new borrowing. However, it may be argued that given historically low interest rates and the Council's access to cheap

money via the Public Works Loan Board that a more aggressive capital programme with a specific objective to acquire assets with a view to making a financial return could be implemented.

Current practice is to create a three-year Capital Plan which is refreshed every two years; the next refresh is due for the 2020/21 financial year, which could incorporate a programme to acquire investment properties.

Minimum Revenue Provision

14. Minimum Revenue Provision (MRP) is the requirement of the Council to set aside cash sums to repay borrowing. The key features of MRP are:

    - MRP would result in a charge to the General Fund
    - Generally, the annual MRP charge would equate to the term of the underlying loan; so a 50 year loan would require an annual MRP charge of 2% - after 50 years the cash set aside would therefore cover the loan principal
    - The charge to the General Fund would be in addition to the annual interest charge

15. MRP may not apply in certain circumstances (often associated with borrowing to finance subsidiary companies) but in a simple case where a loan is taken out to finance a property asset, the combination of interest and MRP charges may offset the rental yield generated by that asset. Generally, where MRP does apply, the net yield achieved by local authorities through property acquisitions may only be in the order of 1% - 2%; the implications of this is that very significant investment may be required to make a material contribution to the General Fund.

Borrowing in advance of need

16. The Ministry for Housing Communities and Local Government ("MHCLG") issued revised Investment Guidance ("the Guidance") in February 2018 which made significant changes in the previous guidance in relation to borrowing in advance of need. It now states that authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Where a local authority chooses to disregard the requirements of the CIPFA Prudential Code and the Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the authority should explain:

    - Why the local authority has decided not to have regard to the Guidance or to the Prudential Code in this instance
    - The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing

17. The related Informal Commentary to the Guidance states that this principle applies to both borrowing taken on to finance the acquisition of non-financial, as well as financial investments, so includes loans to third parties.

18. Traditionally, “borrowing in advance of need”, has been widely held to relate to instances where an authority identifies a borrowing need based on its projections of its Capital Financing Requirement (CFR) and opts to secure a preferential rate. Therefore, ability to borrow would be linked to the increasing CFR, demonstrating that borrowing has only been undertaken to support a capital purpose.

19. Overall, the Guidance and Informal Commentary would create a confusing picture around borrowing and what constitutes ‘investment’.

20. Generally, local authorities continue to borrow for investment purposes (so it is clearly a viable course of action) but prior to undertaking borrowing for investment the Council will take professional advice in order that the Council can satisfy itself it has the appropriate legal and constitutional powers to support the proposed loan.

Non-financial objectives

21. In addition to generating financial returns, the Council could also attach other objectives to investment, by, for example, requiring that the investment be in property assets within the Borough, thereby supporting the Corporate Plan objective of creating a ‘strong and lasting economy’. Further, the investment strategy could accept a lower than generally achievable rate of return if specific policy objectives, such as support for new businesses, were satisfied.

Positive aspects	*Negative aspects*
+ Higher financial returns achievable + Conceptually straightforward; risks and rewards should be knowable, if not known + Non-financial (policy) objectives could be addressed	- Would require professional support for implementation and possible also monitoring of property portfolio - Higher risks have to be accepted - Likely to require some level of General Fund borrowing

4. Investment in economic infrastructure and regeneration

More complicated schemes could involve the Council acquiring land and buildings with a view to redevelopment, or financing infrastructure in the Borough such as roads or power supply. Such schemes are likely to require significant investment, would therefore create a need to borrow, and may also feature:

- Multiple funding sources from government, partner organisations, ‘s106 contributions’ levied through the planning process, or business rate generation facilitated through the infrastructure created

- Delivery involvement from joint venture partners
- The creation of 'Special Purpose Vehicles' – corporate arrangements, such as limited companies – set up to channel funding and provide governance on complex projects

Cabinet has already approved the creation of a Housing Development Company (December 2018[3]) in principle which, when operating, is likely to be an example of this type of investment. The high-level pros and cons of such an investment are set out below.

Positive aspects	*Negative aspects*
+ Higher financial returns could be possible + Complexity likely to increase cost and risk + Non-financial (policy) objectives can be addressed as a matter of priority + More opportunities for returns to be enhanced by avoiding MRP, and generally via 'financial engineering' of the arrangement	- Would require professional support for implementation and possible also monitoring of property portfolio - Complexity is likely to increase implementation time - Higher risks have to be accepted - Likely to require some level of General Fund borrowing (an HDC would probably not be necessary if housing was developed through the HRA)

5. Other complex transactions

Examples of complex transactions could be:

- Providing loans to partners at rates in excess of the Council's cost of borrowing
- 'Income-strip' type arrangements where the Council guarantees the future income streams of third-party investors generated by an asset in exchange for a fee and / or future rights over that asset

In the former case, the Council would take advantage of access to low interest rate loans, and provide finance to bring forward delivery of a project (usually fulfilling other policy objectives) in exchange for a 'turn' on interest rates (ie. the Council would offer a loan to a third party at rates above those at which it could borrow[4].

In income-strip type arrangements the Council need not necessarily be an investor in a project but instead provides a covenant guaranteeing future income to investors (typically Pension Funds) who will accept lower returns from investment providing those returns are virtually certain. An example of the latter

[3] See https://charnwood.moderngov.co.uk/ieListDocuments.aspx?CId=137&MId=175&Ver=4

[4] This mechanism could be used, for example, to create revenue out of a loan to a SPV or Council trading company

type of transaction is that of 'Wirral Waters One', an income-strip arrangement being brought forward by Wirral Council[5]. In this transaction Wirral agree to guarantee a minimum level of housing rental income to Aviva in years 11 to 50 of the fifty-year agreement. At the end of this period Wirral have the option to take a peppercorn lease over the majority of housing units for a further 200 years.

As can be evidenced by the Wirral case study, this type of transaction may be very long term in nature and contain risks that are both long term and difficult to quantify. Income-strip schemes provide viable solutions for bringing forward development but must be handled with great care.

Positive aspects	*Negative aspects*
+ Otherwise very difficult (financially) projects can be delivered + Higher financial returns could be possible + Complexity likely to increase cost and risk + Non-financial (policy) objectives can be addressed as a matter of priority + More opportunities for returns to be enhanced by avoiding MRP, and generally via 'financial engineering' of the arrangement	- Would require professional support for implementation - Transactions may be very complex - Associated professional fees may be significant – and may have to be written off if project not ultimately viable - Complexity is likely to increase implementation time - Higher risks have to be accepted and these may be in the very long term - Some level of General Fund borrowing may be necessary

6 Investment in social housing through the Housing Revenue Account

The Council already has a £2.8m programme of investment within the Capital Plan to acquire properties and increase the Council's social housing stock. Some additional borrowing headroom could be identified within the Housing Revenue Account (HRA) to accelerate this process if such a policy were pursued. Investment within the HRA however, has no impact on the General Fund budget and could not be a contributor to the overall financial sustainability of the Council.

<u>Alternatives to investment – paying down existing debt</u>

22. Paying down existing debt may in theory provide a superior financial returns to available investment opportunities. Two possibilities are open to the Council:

Early repayment of £2m loan within the General Fund

23. This loan was taken out in 1984 at what now appears a punitive interest rate of 11.625%. Given the disparity between prevailing interest rates and that payable

[5] https://democracy.wirral.gov.uk/documents/g7390/Public%20reports%20pack%2001st-Oct-2018%2010.00%20Cabinet.pdf?T=10

on the loan the Council has periodically requested early repayment terms. Unfortunately the terms have been such that early repayment has not represented value for money; the loan is now approaching the end of its term (which will be in 2024) and it is envisaged that it will now run its course.

Reduction in pension liability

24. The Council's liability for pension commitments, calculated by the Local Government Pension Scheme (LGPS) actuaries and reflecting the difference between scheme assets and obligations to members stood at £78m at 31 March 2019. In practice the Council will not suddenly need to repay this amount, but it will need to increase its employer contributions over time, such that the scheme deficit is reduced. The current employer pension contribution is around 30%, and given the existing situation, is set for a 'smooth' increase over the medium term[6]. One option available to the Council is to pay a lump sum into the LGPS which would minimise or reverse employer contribution increases.

25. At the point of drafting this report figures for the Council are not available given the current actuarial LGPS revaluation exercise; however, calculations will be available in the autumn which would enable the Council to assess this alternative.

Positive aspects	*Negative aspects*
+ Very low risk	- Returns may be limited - Impact of repayment may not be visible - Opportunities to facilitate other policy objectives are foregone

26. Should a reduction in pension fund liabilities appear attractive a report will be brought to Cabinet for consideration.

<u>Proposed investment strategy for the remainder of financial year 2019/20 and financial year 2020/21</u>

27. The proposals set out below are designed to comply with the Statutory Guidance on Local Government Investments ('the Guidance'), effective from 1 April 2018.

A. Specified investments and loans to other local authorities

28. The Guidance defines in detail what criteria an investment would meet to be categorised as 'specified' but essentially this would include investments falling within the Council's treasury management activities, the management of which is governed according to the Council's Treasury Management Strategy Statement (TMSS), which in turn is in accordance with the guidance.

[6] The LGPS trustees allow gradual, or smoothed, contribution increases for local authority members to avoid significant and adverse changes in contribution rates in the short term

29. One of the criteria of specified investments is that the local authority has a contractual right to repayment within 12 months. Certain loans to other local authorities made by the Council have a term of up to two years, so do not fall strictly within the definition. However, management of this type of financial instrument falls within the TMSS.

30. It is essentially a legal requirement that the Council manages treasury operations in line with the TMSS so this is and will remain a Council policy. The Council is required to review the TMSS on an annual basis.

PROPOSAL – REVIEW OF TREASURY MANAGEMENT STRATEGY

From a strategic perspective it is proposed that the TMSS be reviewed in conjunction with our professional advisers with a view to relaxing the existing investment criteria in a judicious manner, accepting additional risk and with a view to achieving additional returns. This would be undertaken for financial year 2020/21 and incorporated in the revised TMSS for this year.

31. Interest rates are at historically low levels and are expected to remain so for several months ahead. Based on an average fund under management of £50m, and an increase in return by an average of 0.1%, this would generate additional income of £50,000 per annum.

B. Loans

32. The Guidance states that a local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for economic growth. This course of action is appropriate providing:

- Total financial exposure to this type of loan is proportionate
- An allowed 'expected credit loss' model for assessing credit risk is adopted[7]
- Appropriate credit control arrangements to cover overdue payments are in place
- The local authority has formally agreed the total level of loans by type that it is willing to make, and the total loan book is within that self-assessed limit

PROPOSALS

Loan to third parties

33. The Council will not proactively seek to market loans to third parties but will consider offering loans to local enterprises, local charities, on a case by case basis, as and when approached.

[7] As defined within International Financial Reporting Standard 9 – in broad terms the likelihood of a creditor defaulting in future must be considered in accounting for impairment (compared to previous Standards in which accounting was based on actually incurred losses)

No money will be set aside within the forthcoming Capital Plan.

Should an opportunity to offer a loan to a third party arise reports will be taken to Cabinet, and Council if required, to seek specific approval for that transaction.

All prospective debtor organisations will be either be located, or will have substantial operations, within the Borough.

Any asset created through the loan will be located within the Borough.

The purpose of the loan will support local economic growth as defined within the extant Corporate Plan.

The maximum total loan book the Council would manage will be £10m.

The maximum single loan to an individual organisation will be:

- Secured loan £5m
- Unsecured loan £2m

The maximum total value of unsecured loans will be £4m.

Loans will be offered on a commercial basis with rates offered dependent on risk; unsecured loans will attract higher interest rates. Rates offered will be in accordance with independent professional advice

Due diligence will be carried out on prospective debtor organisations.

34. Generally, independent professional advice will be taken to ensure that the structure of loan finance offered, and the risk and return associated with that structure is appropriate.

Loans to joint venture and wholly owned subsidiary companies

35. The Council has already stated it intends to set up a Housing Development Company (HDC)[8]. Detailed proposals for the corporate structure of the HDC or specific site development are not yet available but to reiterate that statement of intent it is proposed as follows:

[8] See: http://intranet.charnwood.local/papers/cabinet/20181213/Published%20Items/Cab%2013%20December%202018%20Agenda%20Pack%20(modern.gov).pdf

An amount of £10m to fund the HDC will be allocated within the forthcoming Capital Plan.

This funding *may* be in the form of a loan to the HDC, upon which interest and subsequent repayment of principal will be due to the Council.

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £5m in 2022/23.

It is assumed that this funding be financed through Council borrowing, as and when investment is required.

At minimum, interest and principal repayments will cover all of the Council's borrowing costs, in cases where the subsidiary company is wholly owned by the Council.

At minimum interest and principal repayments will cover all of the Council's borrowing costs, plus a margin of in cases where a subsidiary company or joint venture is only partially owned by the Council. This margin will be assessed on a case by case basis and set to ensure both compliance with State Aid rules and an appropriate representation of underlying loan risks and collateral.

Professional advice will be taken to ensure:

- The loans are structured in the most advantageous way, having regard to risk, prospective returns, and tax implications
- MRP can be avoided or mitigated through the loan structure

Appropriate due diligence will be carried out on prospective partner organisations.

36. Given that no concrete proposals are yet in place, no impact is assumed on the Council's finances for the purposes of the MTFS projections.

C. Non-financial and ad-hoc investments

37. This category could include investment in, for example:

- Investment properties
- Wholly owned companies and joint ventures
- Wider scale and more ambitious regeneration projects
- Ad-hoc complex investments

38. The Guidance describes non-financial investment as being in non-financial assets held primarily or partially to generate a profit. Usually it will be expected that the underlying asset could be 'realised' to recoup the capital invested.

39. In terms of reporting it will be necessary to state whether:

- The fair value of non-financial investments is sufficient to provide security against losses, and that the underlying assets provide adequate security for the originating capital investment

- Where the fair value is insufficient detail of mitigating actions should be provided to protect the capital invested
- Additionally, where the fair value assessment recognises a loss in the non-financial investment the subsequent Capital Strategy will need to reflect the impact of loss of security and the associated revenue consequences

40. Fair value accounting in this context is covered by International Financial Reporting Standard 9, as modified by a five-year statutory override applicable to local authorities (covering financial years from 2018/19). The implication of the override is that if a local authority recognises a loss on investment then this will not impact on the general fund, or, therefore, on an authority's ability to set its budget. However, the override is (currently) time limited and a major downturn in the value of specific assets, or the property market generally, represents a clear risk in future financial periods.

Investment properties

PROPOSAL – INVESTMENT IN COMMERCIAL PROPERTY

An amount of £10m to expand the Council's commercial property portfolio will be added to the forthcoming capital plan.

A maximum of £5m will be invested in any single property.

The minimum gross yield acceptable will be based on extant commercial yields and informed by professional advice:

- Default minimum yield would be in line with benchmark commercial property yields (currently around 7%)
- Where additional policy objectives are also satisfied a yield equating to the default amount, less 2% would be acceptable (ie. 5% in current market conditions)

All property acquisitions will be located within the Borough.

Reserves will be created out of rental income to allow for the impact of:

- MRP requirements
- Allowance for void rental periods and landlord repair obligations

After creation of reserves, and taking account of actual or notional[9] borrowing costs, the minimum net yield expected on individual acquisitions will be 1.6% (based on current market conditions, representing a 1% uplift on the return on the specified investment portfolio).

Appropriate independent professional advice will be sought for each property acquisition.

All acquisitions will be subject to separate evaluation and approval by Cabinet.

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £5m in 2022/23.

41. For the purposes of MTFS projections it is assumed that:

[9] In evaluating prospective acquisitions it will be assumed that borrowing costs will be incurred (whether or not borrowing is required); this is to allow like for like evaluation of acquisitions independent of financing.

- £5m will be invested in 2021/22
- A further £5 will be invested in 2022/23
- Average net yield, as set out above, will be 1.5%; this equates to a contribution to the general fund of £75,000 in 2021/22 and £150,000 in 2022/23

Investment in wholly owned companies and joint ventures

42. Should circumstances suggest, it may be appropriate to invest directly in the equity of a Housing Development Company, rather than in the form of a loan, as described above. The basis of investment will be equivalent, as described below.

PROPOSAL – INVESTMENT IN HOUSING DEVELOPMENT COMPANY

An amount of £10m to fund the HDC will be allocated within the forthcoming Capital Plan.

This funding *may* be in the form of an equity investment in the HDC, upon which dividends or and / or management fees will be due to the Council.

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £5m in 2022/23.

It is assumed that this funding be financed through Council borrowing, as and when investment is required.

At minimum, dividends and management fees will cover all of the Council's borrowing costs, in cases where the subsidiary company is wholly owned by the Council.

At minimum dividends and management fees will cover all of the Council's borrowing costs, plus a margin of in cases where a subsidiary company or joint venture is only partially owned by the Council.

Professional advice will be taken to ensure:

- The loans are structured in the most advantageous way, having regard to risk, prospective returns, and tax implications
- MRP can be avoided or mitigated through the loan structure

Appropriate due diligence will be carried out on prospective partner organisations.

43. In total, the maximum investment in a HDC, whether by loan or equity investment, will be an amount of £10m.

Other non-financial and ad-hoc investments

44. Investment in other types of asset, or in larger and more complex arrangements, is not considered within this iteration of the Commercial Investment strategy. In practice, should opportunities arise, the Commercial Investment and Capital Strategies could be amended, subject to the approval of full Council, to allow emerging opportunities to be exploited. It can also be assumed that any significant investment would be subject to the specific approval by Cabinet.

45. For clarity, the above proposals are summarised at Appendix B.

MTFS / budget assumptions

46. Based on the above proposals, the impact on the Councils general fund budget in future years is projected as follows:

Projected contributions to the general fund

PROPOSAL	*2020/21 £000*	*2021/22 £000*	*2022/23 £000*
Review of TMSS	50	50	50
Investment in commercial properties	0	75	150
TOTAL ASSUMED	**50**	**125**	**200**

47. Investment in the Housing Development Company may be undertaken on a 'break-even' basis hence no positive contribution is assumed.

48. Other investment would occur on an opportunistic basis; hence again, no positive contribution is assumed.

Appendices

Appendix A – Summary of the Council's current commercial property portfolio

Appendix B – Summary of specific Commercial Investment proposals

APPENDIX A – REVIEW OF PRINCIPAL COMMERCIAL PROPERTY PORTFOLIO

(All numbers £000 unless stated, derived from 2019/20 original budget)

Woodgate Chambers (budget M825)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
81.6	28.8	5.0	15.4	49.2	**32.4**	646.3	5.0%
		Based on 5% salary cost of Facilities Manager and Building Surveyor ***Other indirect overheads, such as finance, legal, etc, are ignored within these calculations***	Finance charge equivalent to depreciation			Value per Wilks Head & Eve, 2019 (This is below the c.£1+m cost of this asset)	Based on the cost of the asset, yield would be c.3%

Chainbridge Industrial Estate (budget P105)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
130.2	3.4	3.0	15.1	21.5	**108.7**	1,207.1	9.0%
		Based on 5% salary cost of Facilities Manager				Value per Wilks Head & Eve, 2019	

Meadow Lane Industrial Site (budget P125)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
168.3	11.1	5.0	16.7	32.8	**135.5**	1,325.1	10.2%
		Based on 5% salary cost of Facilities Manager and Building Surveyor				Value per Wilks Head & Eve, 2019	

Ark Business Centre (budget P135)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
77.6	50.9	39.4	5.4	95.7	**(18.1)**	446.4	Negative
		Based 5% share of FM and BS (as above), plus direct staffing of reception				Value per Wilks Head & Eve, 2019	NOTED AS REQUIRING ATTENTION AS PART OF COMMERCIALIS'N AGENDA

Oak Business Centre (budget P136)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
189.7	75.7	39.4	15.2	130.3	**59.4**	1,217.0	4.9%
		Based 5% share of FM and BS (as above), plus direct staffing of reception				Value per Wilks Head & Eve, 2019	

Messenger Close (budget P115)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
43.8	0	3.0	1.8	4.8	39.0	441.6	8.8%
	Newly created compounds – no maintenance budget early years	Based on 5% salary cost of Facilities Manager				(£380k land + ~ £130k site development costs incurred) Value per Wilks Head & Eve, 2019	Based on original land value + development costs yield would be ~ 7%

Town Hall Chambers (part budget M835)

INCOME	Direct costs	Directly attributable recharges	Capital financing	TOTAL COSTS	NET SURPLUS / (DEFICIT)	LATEST VALUATION	CALCULATED YIELD
23	0	3.0	2.1	5.1	17.9	None available	N/A
	Full tenant repairing lease	Based on 5% salary cost of Facilities Manager	Apportionment – third of £6.4k				Building is unlikely to be valued in excess of £250k – yield therefore exceeds 7%

Other properties of note

- Southfields offices – not principally held as a commercial property but generates £198k p.a through hosting partner organisations (LCC, DWP)
- Limehurst Depot – vacant brownfield site; work ongoing to overcome planning constraints and develop this site

APPENDIX B – SUMMARY OF SPECIFIC COMMERCIAL INVESTMENT PROPOSALS

Proposals for prospective adoption within the Capital Strategy are as follows:

PROPOSAL – REVIEW OF TREASURY MANAGEMENT STRATEGY

From a strategic perspective it is proposed that the TMSS be reviewed in conjunction with our professional advisers with a view to relaxing the existing investment criteria in a judicious manner, accepting additional risk and with a view to achieving additional returns. This would be undertaken for financial year 2020/21 and incorporated in the revised TMSS for this year.

PROPOSALS IN RESPECT OF LOANS

Loan to third parties

The Council will not proactively seek to market loans to third parties but will consider offering loans to local enterprises, local charities, on a case by case basis, as and when approached.

No money will be set aside within the forthcoming Capital Plan.

Should an opportunity to offer a loan to a third party arise reports will be taken to Cabinet, and Council if required, to seek specific approval for that transaction.

All prospective debtor organisations will be either be located, or will have substantial operations, within the Borough.

Any asset created through the loan will be located within the Borough.

The purpose of the loan will support local economic growth as defined within the extant Corporate Plan.

The maximum total loan book the Council would manage will be £10m.

The maximum single loan to an individual organisation will be:

- Secured loan £5m
- Unsecured loan £2m

The maximum total value of unsecured loans will be £4m.

Loans will be offered on a commercial basis with rates offered dependent on risk; unsecured loans will attract higher interest rates. The rates offered will be assessed on a case by case basis and set to ensure both compliance with State Aid rules and an appropriate representation of underlying loan risks and collateral.

Due diligence will be carried out on prospective debtor organisations.

Loans to joint venture and wholly owned subsidiary companies (Housing Development Company)

An amount of £10m to fund the HDC will be allocated within the forthcoming Capital Plan.

This funding *may* be in the form of a loan to the HDC, upon which interest and subsequent repayment of principal will be due to the Council.

£10m will be the maximum amount of investment and will cover potential loans and equity investment

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £5m in 2022/23.

It is assumed that this funding be financed through Council borrowing, as and when investment is required.

At minimum interest and principal repayments will cover all of the Council's borrowing costs, plus a margin. This margin will be assessed on a case by case basis and set to ensure both compliance with State Aid rules and an appropriate representation of underlying loan risks and collateral.

Professional advice will be taken to ensure:

- The loans are structured in the most advantageous way, having regard to risk, prospective returns, and tax implications
- MRP can be avoided or mitigated through the loan structure

Appropriate due diligence will be carried out on prospective partner organisations.

PROPOSAL – INVESTMENT IN COMMERCIAL PROPERTY

An amount of £10m to expand the Council's commercial property portfolio will be added to the forthcoming capital plan.

A maximum of £5m will be invested in any single property.

The minimum gross yield acceptable will be based on extant commercial yields and informed by professional advice:

- Default minimum yield would be in line with benchmark commercial property yields (currently around 7%)
- Where additional policy objectives are also satisfied a yield equating to the default amount, less 2% would be acceptable (ie. 5% in current market conditions)

All property acquisitions will be located within the Borough.

Reserves will be created out of rental income to allow for the impact of:

- MRP requirements
- Allowance for void rental periods and landlord repair obligations

After creation of reserves, and taking account of actual or notional borrowing costs, the minimum net yield expected on individual acquisitions will be 1.6% (based on current market conditions, representing a 1% uplift on the return on the specified investment portfolio).

Appropriate independent professional advice will be sought for each property acquisition.

All acquisitions will be subject to separate evaluation and approval by Cabinet.

PROPOSAL – INVESTMENT IN HOUSING DEVELOPMENT COMPANY

An amount of £10m to fund the HDC will be allocated within the forthcoming Capital Plan.

£10m will be the maximum amount of investment and will cover potential loans and equity investment.

This funding *may* be in the form of an equity investment in the HDC, upon which dividends or and / or management fees will be due to the Council.

Pro tem it will be assumed that this funding is phased £5m in 2021/22 and £5m in 2022/23.

It is assumed that this funding be financed through Council borrowing, as and when investment is required.

At minimum, dividends and management fees will cover all of the Council's borrowing costs, in cases where the subsidiary company is wholly owned by the Council.

At minimum dividends and management fees will cover all of the Council's borrowing costs, plus a margin of in cases where a subsidiary company or joint venture is only partially owned by the Council.

Professional advice will be taken to ensure:

- The loans are structured in the most advantageous way, having regard to risk, prospective returns, and tax implications
- MRP can be avoided or mitigated through the loan structure

Appropriate due diligence will be carried out on prospective partner organisations.