Investment Strategy Report 2020/21 (DRAFT)

Cotswold District Council

Introduction

The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This Investment Strategy meets the requirements of the statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Treasury Management Investments

In general, the Council receives its income (e.g. from taxes and grants) before it pays for its expenditure (e.g. through payroll and invoices). As a Council Tax 'billing authority' it collects local taxes on behalf of other local authorities and the Police and also holds reserves for future expenditure. These activities lead to a cash surplus at various points of the year which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.

The balance of treasury management investments is expected to average at £31.4 million during the 2020/21 financial year.

Contribution: The contribution that these investments make to the objectives of the Council is to provide income to fund operational activity in support of the Council's priorities.

Further details: Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in a separate document – the Treasury Management Strategy - which is available via the Councils website.

Service Investments: Loans

Contribution: The Council lends money to support local public services and stimulate local economic growth. These include loans to organisations and residents within the district which support the priorities of the Council.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £

Category of borrower	31.3.2019 actual £			2020/21
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Charities	442,435	0	442,435	425,000
Registered Providers	31,500	0	31,500	30,031,500
Local residents (equity loans)	136,247	0	136,247	136,247
Employees (car loans)	68,973	0	68,973	78,973
TOTAL	**674,273**	**0**	**674,273**	**30,671,720**

The approved limit for Registered Providers has been increased by £30 million to reflect the Council's priority of investing in affordable housing. These loans would be secured upon property assets. Provision for this new lending has been included in the Capital Programme as part of the Council's emerging Commercialisation Strategy. Any proposed lending would be subject to Council approval of a business case and a due diligence process.

As part of the Council's Commercialisation Strategy, the Council may consider loans to other entities, for example green energy providers. This lending would be subject to consideration of a business case and due diligence work. The business case would include the implications for this Investment Strategy.

Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The loans that the Council has made are limited to specific service areas and the likelihood of non-payment is minimal. There is no history of non-payment and no evidence to suggest that there will be any default against the loans granted. As a result, no allowance for loss has been included against the loan balances. Should any indication be given that there is a risk of default then the risk will be assessed and a provision established at that time. Should a loan default, the Council will make every reasonable effort to collect the full sum lent and recover any overdue repayments.

In addition to the loans granted the Council has included provision in its Treasury Management Strategy to loan up to £500,000 to both Ubico Limited and Publica Group (Support) Limited, should either company require support. The Council is a shareholder in Ubico and a shared owner in Publica. In both cases, the loan facility is to enable the Council to be able to provide a loan for short-term cash flow purposes. No loans were in place at 31.3.2019.

Risk assessment: The Council assesses the risk of loss before entering into and whilst holding service loans by undertaking credit checks and ensuring that appropriate legal documentation is in place to secure the Council's money.

The Council also receives professional advice on its financial dealings from its Treasury Advisors, Arlingclose.

__Service Investments: Shares__

Contribution: The Council has a £1 shareholding in Ubico Ltd. Ubico Ltd is an environmental services company which provides household and commercial refuse collection, recycling, street cleansing, grounds maintenance and fleet maintenance services to the Council. Ubico Ltd is wholly-owned by seven local authorities and operates as a not for profit enterprise.

The Council has no other shareholdings.

Security: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. The Council's investment is fixed at £1.

Table 2: Shares held for service purposes in £

Category of company	31.3.2019 actual £			2020/21
	Amounts invested	Gains or losses	Value in accounts	Approved Limit
Local authority-owned company	1	-	1	1
TOTAL	**1**	**-**	**1**	**1**

Risk assessment: the Council has not invested into Ubico to generate a financial return. The Council has invested in Ubico to support service delivery. Ubico is a cost sharing company – any surplus generated within Ubico is returned to the partner Councils [shareholders]. Similarly any deficit has to be met by the Councils. Through regular budget monitoring and transparency around contract sums and performance, and regular communication with the Council, the risk of any financial loss is mitigated and minimised.

Liquidity: the Council has not invested into Ubico to generate a financial return. The Council has invested purely to facilitate service provision. The Council has no intention to dispose of its investment in the foreseeable future.

Non-specified Investments: Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

__Commercial Investments: Property__

Investment Property is defined in the CIPFA code of practice on Local Authority Accounting as property (land or buildings, or both) held solely to earn rentals or for capital appreciation, or both. The Council holds a number of assets which it classifies as Investment Properties.

Contribution: The Council owns a number of Investment Properties within the Cotswold district and three significant assets outside of the district, with the intention of generating income to support the revenue budget.

Table 3: Property held for investment purposes in £

Property	01.4.18	31.3.2019 actual £		31.3.2020
	Value in accounts	Gains or (losses)	Value in accounts	Expected value
Investment Property within Cotswold District *	1,225,400	103,600	1,329,000	3,499,000
Investment Property outside of Cotswold District: Superdrug, Worcester	1,200,000	(420,000)	780,000	780,000
Investment Property outside of Cotswold District: Wilkinsons, West Bromwich	1,600,000	(50,000)	1,550,000	1,550,000
Investment Property outside of Cotswold District: Tesco, Seaford	1,018,000	152,000	1,170,000	1,170,000
TOTAL	**5,043,400**	**(214,000)**	**4,829,000**	**6,999,000**

* In April 2019 the Council purchased a new property within the district for a fee of £2,170,000.

Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Council's investment property portfolio is made each year as part of the final accounts process. Investment Property is valued at market value.

The fair value of the Council's investment property portfolio is included in the Statement of Accounts, based upon 'market value'. The Council's Investment Property is held primarily to generate a stable income stream to support the revenue budget. Should a property be sold any profit/loss on disposal will be recognised at that point. The Council has no plans to dispose of any Investment Property in the near future.

Risk assessment: The Council aims to generate a revenue return from its Investment Property assets which is greater than the return generated by its Treasury Management activity. It is understood that the fair value of property will fluctuate. The Council assesses the risk of movement in asset values before entering into and whilst holding property investments and aims wherever possible to mitigate the risk by purchasing property with secure tenants on long leases.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the Council has cash funds that can be accessed when they are needed, the Treasury Management Strategy includes the provision of liquid investments should the Council be in need of cash. It is not anticipated that the Council would need to sell any Investment Property at short notice.

<u>**Loan Commitments and Financial Guarantees**</u>

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

The Council is a shareholder of Ubico Ltd, owning one seventh of the company, and is a joint partner in Publica Group (Support) Limited, owning one quarter of the company. In both cases, should the company overspend the Council would be liable for its share of the additional costs. In both companies, sound financial management and budgetary control mitigate the risk that additional sums will be required without adequate notice.

<u>**Proportionality**</u>

The Council is dependent on investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives of the Council is dependent on achieving the expected income from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected income targets, the Council will be required to draw additional balances from reserves, or generate savings elsewhere within the budget to continue to provide its services.

Table 4: Proportionality of Investments

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Gross service expenditure*	22,462,000	23,264,000	23,413,000	24,644,000	23,362,000
Treasury Investment income	494,568	640,000	585,000	505,000	500,000
Loans income[1]	12,268	12,270	12,270	12,000	12,000
Shares dividends	0	0	0	0	0
Investment Property income	553,556	675,000	553,556	553,556	553,556
Investment income as a proportion of expenditure	4.72%	5.71%	4.92%	4.34%	4.56%

* Excluding Housing Benefit payments. [1] Excludes any income from possible new advances to Registered Providers

<u>**Borrowing in Advance of Need**</u>

Government guidance is that local 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. The Council will need to borrow in 2020/21 to fund new capital schemes. Any funds borrowed will be in relation to specific schemes and based upon the cash required for the chosen schemes. There are no plans to borrow in advance of need.

<u>**Capacity, Skills and Culture**</u>

Summary of knowledge and skills available to the Council:

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Chief Finance Officer is a qualified accountant with over 20 years' experience of working in local government finance. The Deputy Chief Finance Officer is also a qualified accountant with 17 years' experience. The Council pays for junior staff to study towards relevant professional qualifications including Chartered Institute of Public Finance and Accountancy (CIPFA), Association of Certified Chartered Accountants (ACCA) and Association of Accounting Technicians.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. The Council employs other specialist advisers to advise upon specific, extra-ordinary transactions as required. Examples of such transactions include property acquisitions, and loans to third parties. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

The Council has experience of investing in commercial property in recent years. The Council's property service is provided through its strategic service provider Publica Group (Support) Ltd. The team of property officers have the following qualifications:

- BSc Hons Real Estate Management
- Associate Member Royal Institute Chartered Surveyors
- Member Royal Institute Chartered Surveyors
- Royal Institute Chartered Surveyors Registered Valuer
- Member institute welfare & facilities management
- Technical member for institute for occupational safety and health
- Member of chartered institute of marketing

The Council's legal team have experience of carrying out due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications:

- Fellow of the Charter Institute of Legal Executives (FCIlex)
- Associate Member of the Charter Institute of Legal Executives (FCIlex)
- Graduate of the Charter Institute of Legal Executives (FCIlex)
- Para-Legals
- Solicitors

The Property and Legal teams work together with the Finance team to support the Council's Chief Finance Officer and the Publica Finance Director in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.

The Council has previously invested in a range of commercial properties which are delivering a sustainable revenue stream to the Council. Any further investment in non-treasury management transactions will be set out in this, or future iterations of this strategy.

Scrutiny Arrangements:

The Cabinet will make decisions or make recommendations to full Council on new investments that are not part of Treasury Management Activity.

Financial Performance is reported quarterly to the Council's Overview and Scrutiny committee and to Cabinet. This will include the financial performance of the Treasury management function and any other revenue-generating investments.

Treasury Management performance is reported at half-year and year-end to the Council's Audit Committee and to full Council.

The Council's internal audit provider (South West Audit Partnership Ltd) regularly audits the Council's treasury management activity and its processes and procedures for approving investment and performance management. SWAP report to the Council's Audit Committee.

Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to and any guarantees the Council has issued over third party loans.

Table 5: Total investment exposure in £

Total investment exposure	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2021 Forecast**
Treasury management investments	32,203,000	27,000,000	25,000,000
Service investments: Loans	674,273	667,000	31,000,000[2]
Service investments: Shares	1	1	1
Commercial investments: Property	4,829,000	6,999,000	6,999,000
TOTAL INVESTMENTS	37,706,274	34,666,001	62,999,001
Commitments to lend [1]	0	0	0
TOTAL EXPOSURE	37,706,274	34,666,001	62,999,001

[1] This excludes the potential loan facility offered to Ubico Limited and Publica Group (Support) Limited for cash flow purposes.
[2] This reflects the potential for new lending to Registered Providers of £30 million which would be subject to a Business Case to be approved by Council.

How investments are funded: Government guidance is that these indicators should include how investments are funded. The Council's plans for borrowing are limited to a small number of schemes – which are primarily for service delivery – which do not form part of this report. As a result, investments funded by borrowing can be presented as follows:

Table 6: Investments funded by borrowing in £

Investments funded by borrowing	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2021 Forecast**
Treasury management investments	0	0	0
Service investments: Loans	0	0	30,000,000
Service investments: Shares	0	0	0
Commercial investments: Property	0	0	0
TOTAL FUNDED BY BORROWING	**0**	**0**	**0**

The £30 million included in Table 6 for loans related to service investment is to enable the delivery of affordable homes in the District. Whilst this loan is service related rather than a loan for investment purposes (i.e. lending made specifically to generate a revenue return for the Council), it has been included Table 6 for transparency purposes.

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

(Commercial Property returns are calculated based upon returns compared to the current market valuation of the asset, not the purchase price).

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	**2018/19 Actual**	**2019/20 Forecast**	**2020/21 Forecast**
Treasury management investments – Average return	0.6%	1.2%	1.9%
Service investments: Loans			
Charities[1]	2.3%	2.7%	2.7%
Housing association	0.0%	0.0%	0.5%[3]
Local Authority Mortgage Scheme[2]	3.0%	NA	NA
Local residents (equity loans)	0.0%	0.0%	0.0%
Employees (car loans)	2.0%	2.0%	2.0%
Service investments: Shares	0.0%	0.0%	0.0%
Commercial investments: Property	7.8%	8.0%	8.0%

[1] This represents an average return based upon loans ranging from 0% to 3.5%.
[2] The Local Authority Mortgage Scheme (LAMS) investment ended and was repaid in January 2019.
[3] Reflects the margin increase in interest rate over and above the interest rate that the Council would be paying on its borrowing.