

## Investment Strategy Report 2019/20

### Tewkesbury Borough Council

#### Introduction

The Authority 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 or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the Government in January 2018, and focuses on the second and third of these categories.

#### Treasury Management Investments

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus 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 fluctuate between £15m and £34m during the 2019/20 financial year.

**Contribution:** The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

**Further details:** Full details of the Authority's policies and its plan for 2019/20 for treasury management investments are covered in a separate document, the Treasury Management Strategy.

#### Service Investments: Shares

**Contribution:** The Council invests in the shares of a jointly owned teckel company (Ubico Ltd) to support local public services (environmental services). Tewkesbury Borough Council have a £1 share and there are 6 other authorities each owning £1 each.

The purpose of the investment is to work with other local authorities to create efficiencies and resilience within our environmental services and also enable a more commercial outlook within the company.

**Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. As the only shares we have are nominal and relate to a service objective then there is no risk of falls in value.

### **Other Shares**

We also hold shares in a Local Authority Property Fund however this is covered within the Treasury Management Strategy.

### **Commercial Investments: Property**

**Contribution:** The Council invests in local and UK wide commercial property with the intent of making a profit that will be spent on local public services. The properties held cover a range of sectors including industrial and retail to spread the risk and include a wide range of lease types and lengths. The income generated from these investments enables us to continue functioning as a council and provide our statutory duties.

Some investments are held for service reasons as well and are immaterial in value. The material items are shown in the table below:

*Table 3: Property held for investment purposes in £ millions*

Property	Actual	31.3.2018 actual	
	Purchase costs	Gains or (losses)	Value in accounts
Land only	1.45	(0.117)	1.33
Office	13.02	0.10	13.12
Industrial	9.83	(0.02)	9.81
Retail	8.23	(0.75)	7.48
Office – bought Aug 18	3.85	0	n/a
Retail – bought Oct 18	4.62	0	n/a
<b>TOTAL</b>	<b>40.97</b>	<b>(0.79)</b>	<b>31.74</b>

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

**Where value in accounts is at or above purchase cost:** A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2018/19 year end accounts preparation and audit process value these properties below their purchase cost, then the risk of the loss of security on investments will be assessed and, if the level of borrowing becomes more than the portfolio value, an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

**Where value in accounts is below purchase cost:** The fair value of the Authority's investment property portfolio is no longer sufficient to provide security against loss however the returns average 5.93% (gross) against investment so continue to outperform against treasury investments. The amount borrowed is less than the fair value of all the assets and so we do not believe our capital to be at risk because we have no intention to sell in the short term. A decreasing value is often seen as the lease timeframe erodes but will potentially return to higher levels on the completion of new long term leases.

**Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding property investments by:

- using professional property advisers (LSHIM) to assess the full cost of any potential commercial property purchase, including void periods;
- ensuring an exit strategy by looking at the alternative use for the property;
- costing any asset management requirements required and setting aside monies in the budget;
- looking at lease lengths and break clauses to ascertain the risk of any voids and to enter early negotiations with tenants;
- ensuring a minimum rate of return that enables all known costs to be covered;
- diversifying the portfolio over a number of sector areas.
- Undertaking an independent valuation exercise to substantiate the purchase price prior to completion
- Undertaking other building and environmental surveys
- Reviewing the strength of covenant of the existing tenant
- Reviewing the strength of economy in the surrounding area

**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 invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority would use professional agents to sell these assets to maximise best value.

### **Proportionality**

The Authority is dependent on profit generating 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 Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Authority's contingency plans for continuing to provide these services are to firstly use any contingency reserves available to continue to provide these services in the short term whilst an assessment of the investments future capabilities are made and then cost reductions would be made to ensure the council is financially viable in the longer term.

Table 4: Proportionality of Investments

	<b>2017/18 Actual £'000</b>	<b>2018/19 Forecast £'000</b>	<b>2019/20 Budget £'000</b>	<b>2020/21 Budget £'000</b>	<b>2021/22 Budget £'000</b>
Gross service expenditure	37,267	37,723	33,839	34,450	35,286
Net investment income	1,427	1,409	1,497	1,574	1,576
Proportion	4%	4%	4%	5%	4%

### **Borrowing in Advance of Need**

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 Authority has chosen not to follow this guidance and has previously borrowed for this purpose because, as a small council with the 5<sup>th</sup> lowest council tax in the country, the level of cuts to core government support along with losses associated with the retained business rates scheme and the growing size of the Borough mean that the Council would be unlikely to balance its budget without this income and therefore would be forced to reduce service offering drastically. It would also heighten the potential for issuing a s114 notice. The 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, is to always have a fixed rate for borrowing for at least 40% of investments to manage the risk of interest rate increases. In addition, the Council ensures any rental income is managed and leases are reviewed early to allow for any potential break clauses and void periods which can be factored into the budget.

### **Capacity, Skills and Culture**

#### **Elected members and statutory officers:**

A Commercial Investment Board was set up along with an approved Commercial Investment Strategy (Council, December 2016) to provide a level of scrutiny and governance around property purchases. The board consists of six Members and council officers (to include the Head of Finance and Asset Management and the Asset Manager) who receive investment proposals and evaluate individual proposals for bidding.

#### **Commercial deals and corporate governance:**

Lambert Smith Hampton Investment Management (LSHIM) were appointed as our professional property investment advisers. The Council gave them the total amount of money available for investment and the minimum net return we will accept and they recommended a balanced portfolio between industrial, retail and office accommodation in order to spread the risk between sectors.

When a property comes to the market that LSHIM believe fits this criteria they will send us a summary to see whether we are interested in pursuing it further. If we choose to look into

the investment we commission LSHIM to perform their due diligence and prepare a full report on the property.

Detailed analysis of any potential bids are received by the board outlining the risks, returns, any existing tenancies and asset management opportunities for the property explained. LSHIM are aware of the differing requirements of a local authority and recommend properties that would fit within our approved commercial strategy and risk appetite. Detailed financials are received outlining possible net returns to us which include our statutory costs such as minimum revenue provision (MRP) and also allow for voids and conservative estimates of any rent increases.

Authority of investments up to £12m can be made by the Head of Finance and Assets in consultation with the Commercial Investment Board whereas anything over £12m is referred to the Executive Committee for deeper scrutiny and decision making.

### **Investment Indicators**

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

**Total risk exposure:** The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down.

*Table 5: Total investment exposure in £millions*

<b>Total investment exposure</b>	<b>31.03.2018 Actual</b>	<b>31.03.2019 Forecast</b>	<b>31.03.2020 Forecast</b>
Treasury management investments	15.2	12.1	10.4
Commercial investments: Property	32.5	38.8	45.5
<b>TOTAL INVESTMENTS</b>	<b>47.7</b>	<b>50.9</b>	<b>55.9</b>

**How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

We have no treasury management investments funded by borrowing and have no plans to do this in the future either.

Table 6: Investments funded by borrowing in £millions

Investments funded by borrowing	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Commercial investments: Property	21.00	29.40	36.10
<b>TOTAL FUNDED BY BORROWING</b>	<b>21.00</b>	<b>29.40</b>	<b>36.10</b>

**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 initially 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.

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

Investments net rate of return	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury management investments	0.98%	1.39%	1.63%
Commercial investments: Property	5.78%	4.12%	3.21%
<b>ALL INVESTMENTS</b>	<b>4.07%</b>	<b>2.96%</b>	<b>2.66%</b>

Table 8: Other investment indicators

Indicator	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Loan to value ratio	0.66	0.72	0.76
Investment cover ratio	3249	643	421
Vacancy levels	0	0	0