Appendix B

Investment Strategy Report 2020/21

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 meets 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 £25m and £35m during the 2020/21 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 2020/21 for treasury management investments are covered in a separate document, the Treasury Management Strategy.

Service Investments: Loans

Contribution: The Council may lend money to local businesses/charities to support local public services and stimulate local economic growth. Although a loan agreement for £30k is being drawn up, it currently isn't in place at the time of writing this report.

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 Authority, we ensure that any default in the repayment is affordable for the Council.

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figure for any loans in the Authority's statement of accounts at the end of 2019-20 will be shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding service loans. As we only have one in progress we have assessed their credit rating and also ensured we could afford any financial loss of a default in repayment.

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 shows in the table below:

Table 3: Property held for investment purposes in £ millions

Property	**Actual**	**31.3.2019 actual**	
	Purchase costs	**Gains or (losses)**	**Value in accounts**
Land only	1.5	(0.2)	1.3
Office	22.9	0.1	23.0
Industrial	3.8	(0.3)	3.5
Retail	12.9	(0.6)	12.3
TOTAL	**41.1**	**(0.1)**	**40.1**

Security: In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is higher than its purchase cost (including taxes and transaction costs) or, overall, the value of material investment properties are no less than 10% lower than purchase cost. A fall in the value of the property does not impact on the council as it is reversed out in the Movement in Statement of Reserves. The council is concerned about the net income return as this is crucial to the budget.

Where value in accounts is below purchase cost: The fair value of the Council's investment property portfolio is lower than the original purchase price as the fair value looks at the length of any leases currently in place (and as the lease term diminishes the fair value falls). If the value falls a significant amount (10% or more) then further work is done to identify whether any mitigating actions are needed to protect the capital invested. These actions include analysing any risk of lease defaults or cancellations and ensuring contingency funds are in place to mitigate any material impact on the budget.

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 Council would use professional agents to sell these assets to maximise best value.

Proportionality

The Council 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, Council's contingency plans for continuing to provide these services 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

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Gross service expenditure	37,736	32,471	33,489	33,940	34,287
Investment income	2,147	2,209	2,055	2,340	2,351
Proportion	6%	7%	6%	7%	7%

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 5th 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

Total investment exposure	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2021 Forecast**
Treasury management investments	14.9	29.47	28.36
Commercial investments: Property	40.9	47.52	62.52
TOTAL INVESTMENTS	**55.8**	**76.99**	**90.88**

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	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2020 Forecast**
Commercial investments: Property	28.16	34.79	49.79
TOTAL FUNDED BY BORROWING	**28.16**	**34.79**	**49.79**

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	**2018/19 Actual**	**2019/20 Forecast**	**2020/21 Forecast**
Treasury management investments	1.74%	1.41%	2.02%
Commercial investments: Property	3.03%	3.30%	2.76%
ALL INVESTMENTS	**3.32%**	**2.50%**	**2.50%**