AUDIT COMMITTEE – 24 JANUARY 2020

INVESTMENT STRATEGY 2020/21

1. INTRODUCTION

1.1. The Council currently holds, and intends to increase, its exposure in a variety of Investments held for the purpose of generating commercial profit.

1.2. By producing this strategy report, the Council is following statutory guidance issued by the Government in January 2018.

2. OVERVIEW OF WHAT IS INCLUDED IN THE INVESTMENT STRATEGY

2.1. **Treasury Management Investments**

The Investment Strategy has regard to the Treasury Management Strategy, which sets out in detail how the Council's treasury service will invest surplus cash, taking into consideration the requirements of the Council's capital programme, and other financing needs. The balance of treasury management investments fluctuate and can exceed £100m at given points during a fiscal period.

2.2. **Commercial Investments**

The Commercial investments section of the strategy brings together the accumulation of property investment strategies that have been adopted by this Council.

The strategy considers the contribution made by these investments, the security, the risk assessment process and liquidity.

The strategy sets out various performance indicators, designed to assist readers understand the implications of the Council's investing activities on the general fund, and the forecast yields expected from the differing investment categories.

3. ENVIRONMENTAL / CRIME AND DISORDER IMPLICATIONS

3.1. There are no implications arising from this report.

4. RECOMMENDATIONS

4.1. The Audit Committee is recommended to request Council approve the Investment Strategy 2020/21.

For Further Information Please Contact:

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Background Papers:

Treasury Management Strategy 2020/21

APPENDIX 1

Investment Strategy 2020/21

1.0 Introduction

The Authority invests its money for two 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 earn investment income (known as **commercial investments** where this is the main purpose).

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

2.0 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 fluctuate and in the past 12 months, the Council's investment balance has ranged between £63.5m and £105.7m.

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.

3.0 Commercial Investments: Property

Contribution: The Council invests in commercial and residential property with the intention of making a profit that will be spent on local public services. The Council has established a £30m fund for the purposes of investment in commercial property, and a £10m fund exists for investment in residential property. Both funds have been established with the primary intention of generating a profit.

The Council can own commercial property directly, and has established a wholly owned group of companies for the purposes of investment in residential property. The Council intends to make equity investments into the group of companies and issue loans, on the latter of which the Council will receive interest payments. Both strategies also have socioeconomic benefits, such as stimulation of local economies through investment in commercial premises and growth in the supply of housing throughout the District.

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. Three out of the four investment properties owned by this Council as at 31/03/19 have been in the Council's ownership for well over a decade. The first acquisition under the Council Commercial Property Investment Strategy was completed in December 2017 and the first annual revaluation of this asset was undertaken and included in the 2018/19 annual financial report.

The main risk when making 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, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans in £millions

Category of borrower	31.3.2019 actual			2020/21
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries	0.000	0.000	0.000	10.000
TOTAL	**0.000**	**0.000**	**0.000**	**10.000**

Table 2: Shares in £millions

Category of company	31.3.2019 actual			2020/21
	Amounts invested	Gains or losses	Value in accounts	Approved Limit
Subsidiaries	0	0	0	4.000
TOTAL	**0**	**0**	**0**	**4.000**

The figures as included in tables 1 and 2 above are in relation to the wholly owned group of housing companies. The total initial investment, made up of debt and equity is to total £10m. The mix of debt and equity will be fluid, and so for the purposes of setting individual limits, the potential maximum in each instance has been shown, hence equating to more than £10m.

Table 3: Property held for investment purposes in £millions

Property	31.3.17	31.3.2018 actual		2019/20
	Value in Accounts	Gains or (losses)	Value in accounts	Additions
Hythe Marina	2.293	0.247	2.540	
Saxon Inn Calmore	0.183	-	0.183	
Meeting House Lane	0.119	0.007	0.126	
New Milton Health Centre	2.100	0.231	2.331	
Land at Beaumont Park Ringwood				2.010
Ampress Car Park				2.100
TOTAL	**4.695**	**0.485**	**5.180**	**4.110**

Note: The Council holds interests in other properties not designated in the statutory accounts as Investment Properties, as they do not meet the qualifying criteria. These other assets do however also generate a revenue return and include, for example Hardley Industrial Estate and the Lymington Town Hall.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding property investments. Market research is undertaken regularly, and potential opportunities objectively evaluated by the in-house estates team, utilising external expertise as and when necessary.

The Authority assesses the risk of loss before entering into and whilst holding loans through regular communication via the board of directors and the Council. The board has the freedom to engage with specialist consultants as and when required. Purchases of properties and development opportunities are only completed once a full business case has been prepared and signed off by the board, or by the Council if above delegated financial parameters.

Liquidity: Compared with other investment types, property can be relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. The Council will ensure to keep suitable minimum cash balances available, for example to repay capital borrowed.

4.0 Proportionality

The Council is expecting profit generating investment activity to assist in achieving 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 Council will continually review and evaluate its services, and their delivery models, ensuring the most efficient service is provided to the residents of the New Forest. Prudent use of reserves can also be considered as a suitable contingency plan for continuing to provide these services in the short term.

Table 4: Proportionality of non-treasury Investments (£millions)

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Gross service expenditure	42.598	43.248	43.248	43.248	43.248
Investment income	0.303	0.399	0.399	0.821	1.176
Proportion	0.7%	0.9%	0.9%	1.9%	2.7%

5.0 Capacity, Skills and Culture

Elected members and statutory officers:

Commercial Property investments are made pursuant to the Asset Investment Strategy approved by the Council in 2017. An experienced team formed from the Council's finance, estates and valuation and legal departments prepare initial assessments and recommendations concerning suitable properties. Prior to entry into a bidding process, approval must be secured from the Portfolio Holder: Finance, the Executive Director Governance and Regulation and the s151 Officer. Prior to entry into binding legal agreements, final approval must be secured from the Chief Executive, the Executive Director Governance and Regulation and the s151 Officer in consultation with the Portfolio Holder: Finance and the Chairman of the Corporate Overview and Scrutiny Panel for transactions up to £5M, and the approval of Cabinet for transactions above £5M. This detailed process of scrutiny and decision making by key senior officers and members ensures the strategic objectives, risk profiles and overall risk exposure for the Council are considered and fully understood.

Commercial deals:

The Cabinet report dated 20th February 2017 is clear (at para 3.8) the Council will take a prudent approach to the management of financial risk and the assessment of possible investments. The criteria for selecting investment assets set out in the Asset Investment Strategy and the steps for selecting assets set out above accord with prudent investment principles and the key decision makers, including the S151 Officer, are involved in the process to ensure compliance.

Corporate governance:

The Asset Investment Strategy makes express reference (at para 2.1) to the Council's Corporate Plan 2016 – 2020 and was prepared in the context of seeking to deliver on those priorities. The process for selecting assets is set out above to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

6.0 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 and guarantees the Authority has issued over third party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Budget	31.03.2022 Budget
Pooled Fund T M investments	13.50	13.50	8.50	5.00
Other T M investments	50.60	34.20	20.69	5.00
Subsidiary investments: Loans	0.00	0.15	1.05	3.45
Subsidiary investments: Shares	0.00	0.10	0.70	2.30
Commercial investments: Property	5.18	9.29	19.29	29.29
TOTAL INVESTMENTS	**69.28**	**57.24**	**50.23**	**45.04**
Commitments to lend	-	-	-	-
Guarantees issued on loans	-	-	-	-
TOTAL EXPOSURE	**69.28**	**57.24**	**50.23**	**45.04**

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 can 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.

Table 6: Investments funded by borrowing in £millions

Investments funded by borrowing	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Budget	31.03.2022 Budget
Subsidiary investments: Loans	0.0	0.1	1.0	3.4
Commercial investments: Property	1.7	5.0	13.0	21.0
TOTAL FUNDED BY BORROWING	**1.7**	**5.1**	**14.0**	**24.4**

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of external borrowing where appropriate, as a proportion of the sum initially invested.

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

Investments net rate of return	2018/19 Actual	2019/20 Forecast	2020/21 Forecast	2021/22 Forecast
Treasury management investments	1.87%	1.75%	1.75%	1.75%
Subsidiary investments: Loans	0.00%	5.50%	5.50%	5.50%
Subsidiary investments: Shares	0.00%	0.00%	0.00%	0.00%
Commercial investments: Property	5.19%	4.29%	4.29%	3.89%

Notes to table 7:

So as to not distort the annual percentages, investment purchases are assumed to take effect on the first day of a financial year. The reduction in the rate of return for 2019/20 in comparison to 2018/19 is due to the land purchase, which until developed out is non fee-earning.

The table includes an assumption on the incurrence of external financing costs, introduced in 21/22.

The rate of return on Property investments at 5.5% looks to be the highest return, but on the basis that each purchase requires upto 40% equity, which is non income-earning (at least in the medium-to-long term), the revised rate of return is more akin to a maximum of (5.5% x 60%) 3.3%.