

## Investment Strategy Report 2020/21

### Summary

The Council 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), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy is designed to meet the requirements of statutory guidance issued by the Government in January 2018, and focuses on the second of these categories.

### Portfolio and Date Consulted

Finance

Wards Affected

All

### Recommendation

The Executive is advised to:

- (i) NOTE the contents of the Investment strategy;
- (ii) RECOMMEND approval of the Investment Strategy by Full Council

## 1. Resource Implications

- 1.1 As a result of several years of Government funding cuts the Council embarked on a strategy of income generation through investment in property in order to maintain services. Property was also acquired to advance the Council's key priority namely regeneration of Camberley town centre.
- 1.2 In total the Council has £171m invested in property which was budgeted to generate a net income of £3.8m towards services.

## 2. Key Issues

- 2.1 New guidance in relation to investment was issued by the Government in December 2017 and further guidance was issued by CIPFA in 2019. This Guidance was issued in response to the growth in commercial investment by Councils as a way of balancing their books and maintaining services. The objective of the guidance is to provide greater transparency in respect of property acquisition and ownership and in particular for members to enable them to understand the risks inherent in this type of investment.
- 2.2 The guidance has statutory backing and hence all Councils must have regard to it and the completion of an investment strategy complies with these requirements.

- 2.3 Government guidance recommends that Councils should not borrow money to invest in property solely for financial gain. Investment in property should also support local objectives such as securing jobs and employment sites, growing the local economy etc. Generally speaking if an investment is in borough or close to it is assumed that this condition is fulfilled. Whilst other investments are not prohibited the Council has to state clearly its reasons for ignoring the guidance and how it is managing risks etc. All of this Council's investments are either in borough or close to
- 2.4 Property investment is not without risk and the value of investments can rise and fall over time. Given it is the Council's intention to hold property for the longer term the key consideration in the acquisition of any property is the certainty of the income stream to fund the borrowing since ultimately the borrowing costs will fall on the Council's revenue budget.
- 2.5 Extensive due diligence is carried out with each acquisition to assess the security of this income stream and a margin is included to cover voids etc. However as with any investment there are no absolute guarantees but by having the portfolio spread over a number of different tenants in different properties goes some way to minimising this risk.
- 2.6 In respect of the town centre property this has been acquired with a view to regeneration and economic growth of an area rather than for investment return and as such therefore carries a higher risk than property purchased solely for financial gain.
- 2.7 In the short term income from these properties, particular in the current economic climate, is likely to remain under pressure. However in the long run the investment the Council has made in its town centre through refurbishment of the SQ, public realm improvements and the potential redevelopment of LRB should reap dividends and ensure that over the life time of the borrowing to support these, namely 50 years, they should increase in value and recover any valuation losses made.

### **3. Options**

- 3.1 Members can accept, reject or amend the recommendations within this paper.

### **4. Proposals**

- 4.1 It is proposed that the Executive:
- (i) NOTE the contents of the Investment strategy;
  - (ii) RECOMMEND approval of the Investment Strategy by Full Council

## **5. Supporting Information**

- 5.1 The Investment strategy is included as Annexe A within this paper.
- 5.2 Government guidance on local government investment is available on the MHCLG website.

## **6. Corporate Objectives And Key Priorities**

- 6.1 Investment in property not only supports the Council objectives around place in that it supports the local economy but also prosperity in that it generates income to support services and maintains employment sites in the borough.

## **7. Legal Issues**

- 7.1 The Council has to have regard to statutory guidance in respect of Local Government Investments.

## **8. Governance Issues**

- 8.1 Only Full Council can approve capital investments and borrowing limits. In addition this strategy must be approved by Full Council.

## **9. Sustainability**

- 9.1 Investment in property is one of the ways that the Council is not only sustaining its local economy but also sustaining Council services in the face of significant cuts in Government funding.

## **10. Risk Management**

- 10.1 Investing in property is not without risk but it is an area in which local authorities have had a long involvement. Rents can fall, tenants can leave, and costs can rise. In addition the overall value of the asset can also fall sometimes to below the cost of acquisition. The Council takes steps to minimise these risks through a robust due diligence process and having independent valuation to ensure that it does not overpay for acquisitions. It also acquires property with a view to hold them for the long term. However despite all these precautions values investments are still exposed to market conditions.
- 10.2 The Council maintains reserves to enable it to deal with fluctuations in income, say between tenancies, for the short term. In addition as it is the Council's intention to hold property for the longer term any reductions in value are likely to recover over time. That said there are no guarantees that the anticipated income and assets value will be achieved which in turn could put at risk services which are supported by investment income. However this needs to be weighed up against the fact that these services would need to significantly reduce had the Council not invested in property at all.

<b>Annexes</b>	<b>Investment Strategy 2020/21</b>
<b>Background Papers</b>	
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## Investment Strategy Report 2020/21

### Introduction

1. As explained in the summary the Council 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**), and
  - to earn investment income (known as **commercial investments** where this is the main purpose)
2. This investment strategy was first issued in 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second of these categories.

### Treasury Management Investments

3. The Council 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 in the form of Business Rates and Council Tax. 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 average £13m over the 2020/21 financial year.
4. **Contribution:** The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.
5. **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 elsewhere on this agenda.

### Commercial Investments: Property

6. Under guidance issued in January 2018 the Ministry for Housing, communities and Local Government (MHCLG) defines property to be an investment if it is held primarily or partially to generate a profit. This means that property purchased to further regeneration opportunities, such as the SQ shopping centre, are defined as commercial investments.
7. **Contribution:** The Council currently invests in local commercial property to support economic development and regeneration as well as with the intention of making a profit that will be spent on local public services.
8. The Council's current commercial property portfolio falls under either the place or prosperity objective within the corporate plan.

### Place Objective

9. These properties are mainly based within Camberley Town centre and have been purchased to enable the Council to bring forward its regeneration plans as well as driving economic growth within Camberley.
10. The purchase of the SQ and its associated land holdings has enabled the Council secure a development partner for the London Road Block. It has also meant that the Council has been able to take an active part in the management of the centre and to invest to try and halt its decline.

### Prosperity Objective

11. The Council has acquired a number of Industrial Estates and Offices in the borough or just over the boundary. These have been purchase primarily for investment return but also to ensure that these key employment sites remain as they are. i.e. they are not redeveloped for housing etc.

### **Property held for investment purposes in £ millions**

Property	Actual	31.3.2019 actual	
	Purchase cost £m	Gains or (losses) £m	Value in accounts £m
The SQ and associated properties	105	(23)	82
Other Town centre properties	1	0	1
St Georges Industrial Estate	8	1	9
Albany park Industrial Estate	16	3	19
Trade City Industrial Estate	13	(3)	10
Sandhurst Industrial estate	14	(1)	13
Theta	14	0	14
<b>TOTAL</b>	<b>171</b>	<b>(23)</b>	<b>148</b>

12. **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.
13. A fair value assessment of the Authority's investment property portfolio made within the past twelve months has indicated that it is no longer sufficient to provide security against loss, and the authority is taking

actions to protect the capital invested. This includes investing in the property to maintain an income flow to fund the borrowing, attracting longer leases in order to raise the valuation, looking to alternative uses for surplus space and also retaining the property until such time as the valuation recovers

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

- a. Having a knowledge of the local market by looking at rental and vacancy rates and the values of comparable properties. This is primarily why investment has been restricted to the local area where the Council has the greatest knowledge.
- b. The Council employs agents to advise it on the purchase of property who do an assessment of the rental market, assess the risks associated with the tenants and that type of property and also provide an independent valuation which the Council basis its offer on. The council also employs professionals such as surveyors etc. to advice on any maintenance and structural issues.
- c. Generally speaking local advisors are used as they have an understanding of the local Surrey Heath property market. Professional advice is tendered for to ensure that best value is obtained.
- d. Tenants and covenant strength are reviews by the use of credit ratings if appropriate, level of arrears etc. and the results of this are factored in to any offer made.
- e. The properties are all managed by professional external managers who advise on tenancy strategies to ensure that the assets remain fully occupied. These advisors are subject to review by the investment and development team to ensure that they continue to deliver value and drive the Council's investment property forwards.

**15. 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 holds significant cash reserves which can be called upon if required. In addition the Council has not borrowed fully up to its capital funding requirements meaning there is adequate headroom for further funds to be borrowed should liquidity become an issue. That said the Council acquired the properties with the intention of holding them for the medium to long term and is making regular repayments to ensure that loans will be fully paid off within 50 years. This means that even if the value of the assets does not increase the debt outstanding will fall over time.

### **Loan Commitments and Financial Guarantees**

16. Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council. At the date of this report the Council has not made any loans nor entered in to any guarantee arrangements with third parties.

### **Proportionality**

17. The Council has already lost £2.7m in Government funding over the last 8 years, which represents 25% of its net budget, with more reductions anticipated. In order to be able to continue to deliver discretionary services, such as meals on wheels and community transport, the Council has had to generate income to cover this shortfall. In common with many other Councils one of the ways it has done this is through investment in commercial property. Hence the Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role 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 is to fund them from reserves in the short term until the profit improves, increasing income and savings from other services and as a last resort ceasing to provide some or all of the council's discretionary services.

### ***Proportionality of Investments***

	<b>2018/19 Actual £m</b>	<b>2019/20 Forecast £m</b>	<b>2020/21 Budget £m</b>	<b>2021/22 Budget £m</b>	<b>2022/23 Budget £m</b>
Gross service expenditure	43.756	45.471	44.891	45.000	45.900
Investment income	4.318	4.237	4.264	4.349	4.436
Proportion	9.9%	9.3%	9.5%	9.7%	9.7%

### **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 complied with this guidance and has only borrowed to fund capital acquisitions and programs that have been approved and are/have commenced.

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

**Elected members and statutory officers:** The decision as to whether to make an offer for a particular property rests with the Chief Executive advised by the Leader, Deputy Leader, Sec 151 Officer, the Monitoring officer, Executive Head of Investment and Development and other professional advisors as appropriate.



For each potential acquisition detailed information is provided consisting of the expected rents, costs, financial return, borrowing costs, MRP provision, environmental risks, state of the property, tenant strength, state of the rental market etc. this also includes measuring of future cash flows and the impact of voids and investment at lease renewals. Some of this work is done internally by the Investment and development service and some is done with the assistance of external advisors. The Council's asset acquisition strategy stipulates a minimum return of 2% after borrowing costs to ensure that there is a margin for voids etc. and the council is keen to be not over exposed within one particular sector. An exception to this is property acquired in Camberley Town centre which forms part of the Council's regeneration plans. The Council has a number of staff with experience of property acquisition over many years and with that a good knowledge of the inherent risks in property ownership.

**Commercial deals:** Most of the Council's property deals are either negotiated directly or through agents. The agents, who are commercial property companies and work with many Councils, are fully aware of the requirement that the Council is unable to pay more than a red book valuation and of the need to ensure that borrowing entered in to is affordable and prudent.

**Corporate governance:** Although the Chief Executive can recommend that the Council purchases a property she has no authority to complete the purchase, increase the capital program or increase borrowing. All acquisitions have to be approved by Full Council on the recommendation of the Executive. Such approval, if granted, is within agreed financial parameters (in respect of purchase price etc.) and subject to the Chief Executive being satisfied that the due diligence has been satisfactorily completed.

### **Investment Indicators**

The Authority 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 lend but have yet to be drawn down.

### ***Total investment exposure in £millions***

<b>Total investment exposure</b>	<b>31.03.2019 Actual</b>	<b>31.03.2020 Forecast</b>	<b>31.03.2021 Forecast</b>
Treasury management investments	30	15	15
Commercial investments: Property	171	171	171
<b>TOTAL EXPOSURE</b>	<b>201</b>	<b>186</b>	<b>186</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.

***Investments funded by borrowing in £millions***

<b>Investments funded by borrowing</b>	<b>31.03.2019 Actual</b>	<b>31.03.2020 Forecast</b>	<b>31.03.2021 Forecast</b>
Treasury management investments	0	0	0
Commercial investments: Property	179	164	162
<b>TOTAL FUNDED BY BORROWING</b>	179	164	162

**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.

***Investment rate of return (net of all costs) %***

<b>Investments net rate of return</b>	<b>2018/19 Actual</b>	<b>2019/20 Forecast</b>	<b>2020/21 Forecast</b>
Treasury management investments	0.91	1.00	1.00
Commercial investments: Property	2.51	2.46	2.48

A number of other investment indicators are included below in order to monitor the Council's commercial property activity

***Other investment indicators***

<b>Indicator</b>	<b>2018/19 Actual</b>	<b>2019/20 Forecast</b>	<b>2020/21 Forecast</b>
Debt to net service expenditure ratio	3.93	3.78	3.83
Commercial income to net service expenditure ratio	2:12	2:13	2:13