

## THE INVESTMENT STRATEGY (NON-TREASURY) for 2019/20

### 1 **Background Information**

- 1.1 For the purposes of this Strategy “Investment” mean all financial assets and also non-financial assets held primarily to generate income (i.e. investment property).
- 1.2 This Investment Strategy has been produced in accordance with The Government Department guidance on local government investments which requires the production of an Annual Investment Strategy for non-treasury management investments to include risk indicators to allow the level of risk to be assessed.
- 1.3 The council’s Investment Strategy is undertaken within the following context:
  - i) The level of the council’s non-treasury investments is one of the highest of all district authorities and has been for some time.
  - ii) The income generated from non-treasury investments is significant to the council and supports the cost of services. The Council’s Budget Strategy for 2019/20 assumes that income from these types of investment will be nearly £16 million in 2019/20 and sets a remaining target to achieve additional income of £2.070 million by 2022/23 from property related investments in order to balance the budget in future years.
- 1.4 The council invests its money for three board purposes:
  - iii) Because it has surplus cash as a result of its day to day activities or cash that it holds pending the council’s spending plans (known as Treasury Management investments).
  - iv) To support local public services by lending to other organisations (known as service based investments).
  - v) To earn investment income (known as commercial investments where this is the main purpose).
- 1.5 Details of the council’s treasury management investments are contained in the council’s Treasury Management Strategy and are therefore not included in this strategy.

## 2 Total Non-Treasury Investment Exposure

- 1.1 The council's total exposure to non-treasury investments was nearly £300 million as at 31/03/18 and is forecast to increase as set out in Table 1:

**Table 1 – Non-Treasury Investments**

Estimate 31/3/19 £M		Estimate 31/3/20 £M	Estimate 31/3/21 £M	Estimate 31/3/22 £M	Estimate 31/3/23 £M
<b>Investment Property</b>					
272	Existing Investment Property	272	272	272	272
16	Property Investment Strategy	30	30	30	30
<b>Service Based Investments</b>					
0	Invest to Grow Fund Investment	12	15	25	25
0	Manydown	13	14	15	35
7	Service Based Loans	6	5	4	3
<b>295</b>		<b>333</b>	<b>336</b>	<b>346</b>	<b>365</b>

- 1.2 The government guidance requires the council to indicate how the investments are funded (presumably to identify where borrowing has been used). Although local authorities do not normally associate individual sources of funding to specific investments it is possible to say that none of the above investments have been funded from borrowing.
- 1.3 This is a key indicator of the level of risk the council is taking as borrowing to invest is deemed to be extremely risking and is discouraged.

## 2 Expected Rates of Return Indicator

- 2.1 This indicator shows the investment income receivable as a proportion of the sum invested for the non-treasury investments and can be seen in Table 2.

**Table 2 – Average Returns on Non-Treasury Investments**

	2017/18 Actual %	2018/19 Forecast %	2019/20 Forecast %
<b>Investment Property</b>			
Existing Investment Property	5.50	5.50	5.50
Property Investment Strategy Investments	6.90	7.30	6.40
<b>Service Based Investments</b>			
Invest to Grow Fund Investments	0.00	0.00	5.25
Manydown Investments	0.00	0.00	3.20
Service Based Loans	0.00	0.00	0.00

- 2.2 The returns above do not include valuation gains and losses or property running costs.

### 3 Investment Property

- 3.1 The council has a very large Investment Property Portfolio valued in the accounts at £296 million. A summary of the portfolio is shown in Table 3.

**Table 3 – Investment Property Portfolio**

	<b>Value</b>
	<b>31/03/2018</b>
<b><u>Investment Property</u></b>	<b>£m</b>
Houndsmill Industrial Estate	52
Daneshill Industrial Estate	48
Viables	37
Basing View	30
The Malls	25
Festival Place	14
Manydown Land	20
Other Industrial and Commercial Property	46
Property Investment Strategy Properties	24
	296

- 3.2 For the council's historically held Investment Property Portfolio it is not possible to identify the initial sums invested and therefore the actual returns from these properties. It is possible to calculate a simple return based on the value of the properties in the balance sheet and the income generated.
- 3.3 The historically held property portfolio generated £15 million of rent income on properties valued at £272.3 million which is a gross return of 5.5%. After maintenance and running costs the net income is £10 million which is a net return of 3.7%.

### 4 Property Investment Strategy

- 4.1 The council has recently formulated a Property Investment Strategy which aims to invest up to £30 million in new and existing Investment Properties in order to increase the council's income.
- 4.2 The Property Investment Strategy is expected to generate returns in the 5% to 7% range.
- 4.3 Approximately £16 million has already been invested in new properties as part of this strategy. There are plans to invest the remaining £14 million during 2019/20.
- 4.4 In order that commercial investments remain proportionate the council currently has a limit of £30 million for this type of investment, however there are proposals in the Property Investment Strategy to increase this limit to up to £35 million, the increases being funded from future capital receipts.

## Appendix 2

4.5 The individual investments and the expected returns are shown in Table 4.

**Table 4 – Property Investment Strategy Returns**

	<b>Investment Made £'000</b>	<b>Return %</b>	<b>Additional Income £'000</b>
Units 1 to 4 Armstrong Road	4,554	9.6%	436
Units 1 to 2 Stroundley Road	4,993	6.0%	300
Units 1 to 2 Winchester Road	6,019	5.2%	315
Ringway House	470	16.8%	79
	<b>16,036</b>	<b>7.0%</b>	<b>1,130</b>

4.6 Although the primary objective of these investments is to generate additional rent income to balance the council's future budgets they can also make other contributions such as regeneration, economic growth, increased business rates income and replacing local property market failure.

4.7 The council's Budget Strategy for 2019/20 identifies the need to generate an additional £2.070 million per annum from additional property investment in order to contribute towards balancing its future year's' budgets.

4.8 With financial return being the main objective, the council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include vacancies, loss of capital value and increasing maintenance costs. The council has had to strike a balance between security, liquidity and yield based on the contribution the investments make and the council's risk appetite.

4.9 The target returns (%) and gross income (£) from these investments are government recommended indicators and will need to be monitored and reported throughout the year along with any costs associated with the investments (currently none) and the net income.

4.10 When looking at the security of capital for property investments the MHCLG guidance requires the council to look at the fair value of the property and as long as the value does not fall below the price paid for the property then it is deemed to be secure.

4.11 If the value of a property investment drops below the purchase price (excluding costs) then the council will need to determine what mitigation is required in order to maintain the council's future financial stability. This may involve reviewing the property portfolio and identifying properties that are not performing well and if necessary disposing of them.

## Appendix 2

4.12 The investments made and the fair values can be seen in Table 5.

**Table 5 – Value of Property Investment Strategy Investments**

<b><u>Property</u></b>	<b>Investment Made</b>	<b>Original Value</b>	<b>Valuation</b>	
			<b>31/03/18</b>	<b>Gain 31/03/18</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Units 1 to 4 Armstrong Road	4,554	3,250	11,650	3,846
Units 1 to 2 Stroundley Road	4,993	430	6,650	1,227
Units 1 to 2 Winchester Road	6,019	0	5,650	-369
Ringway House, Bell Road	470	1,150	2,100	480
	16,036	4,830	26,050	5,184

4.13 As shown in Table 5, in 2017/18 the Property Investment Strategy Investments had a net valuation gain of £5.184 million (32%) which when added to the income return of 7% increases the notional return for these properties in 2017/18 to 39%.

4.14 As these property acquisitions are very recent there are currently no additional costs associated with them that would reduce the net return.

4.15 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. The council has accepted this liquidity risk because it has considerable cash investments within its treasury management investments that are highly liquid to ensure that it can assess sums when needed.

4.16 Further details on how the risks are managed and the process for ensuring effective due diligence for these investments can be found in the Council's Property Investment Strategy.

4.17 The other main recommended indicators relate to the level of voids (currently none) and the council's dependency on the income from these commercial investments (which equates to about 1% of its total income budget of £132.4 million or 3% of the council's net cost of services in 2018/19) which will also need to be monitored and reported during the year.

4.18 The council's dependency on the income from all of its investment property (including the existing property portfolio) is much higher at £16.6 million or 13% of the total income budget or 43% of the council's net cost of services.

4.19 Once established, any significant changes in the indicators between years would need to be explained in the annual strategy.

## Appendix 2

- 4.20 If the investments fail to meet the budgeted income from rents the short term contingency plan is to make use of the council's Rent Risk Reserve (which currently has a balance of £2.5 million) which would allow the council some time to review the properties and look for opportunities to disinvest or make improvements.
- 4.21 The government recommend that benchmarking is undertaken for commercial investments against other councils and other types of investment. The council does not currently carry out benchmarking for these specific investments however, the property management team have plans to carry out this type of benchmarking once all the investments under the strategy are in place.
- 4.22 In terms of the governance arrangements for these investments, the council has a specific strategy that was approved by Council and it has an asset management plan. The approved strategy set out the criteria, and limits on this type of investment and officers are required to operate within these criteria and limits.
- 4.23 Decisions on commercial investments are made by the Executive Director of Finance and Resources, after consultation with the Portfolio Holder for Property and Development, within the limits and criteria approved in the strategy.
- 4.24 Property and most other commercial investments are also deemed to be capital expenditure and therefore will also be approved as part of the capital programme.
- 4.25 Quarterly monitoring reports on property investment activity under the strategy are presented to the Audit and Accounts Committee and half yearly to Cabinet.

### **5 Invest to Grow Fund**

- 5.1 The council has an Invest to Grow Fund Strategy that has allocated £25 million to be invested in future years via loans to development companies. The primary purpose of the Invest to Grow Strategy is economic development rather than income and therefore the investments will be treated as service based investments once they are made.
- 5.2 For financial planning purposes it has been assumed that £12 million will be invested during 2019/20 and further details of investments will follow in future strategies once the investments are made.

### **6 Manydown Investments**

- 6.1 The council has budget provision of £35 million for investment in the Manydown Project. The scale and timing of the investment is dependent on the terms of the final development agreement with the council's private sector partner.
- 6.2 It is likely that these investments will be considered as a service based investment as income generation is not the primary purpose.
- 6.3 Details of the investment strategy for the Manydown project will follow in future reports once the development arrangement has been finalised.

### **7 Service Based Loans**

- 7.1 The council has a number of loans that it has made for operational purposes to other organisations and individuals. The main loans are £2.297 million lent to Sentinel Housing Association as part of an existing house purchase scheme linked to homelessness prevention and £5.066 million lent to SERCO as part of the arrangements for the newly let waste management service.
- 7.2 The contribution these loans make relate to the direct provision of council priority services and therefore this has been taken into consideration when assessing the risks involved with making these types of loan.
- 7.3 The council's total exposure to this type of loan is currently £7.520 million and all of these loans have been capitalised and have been funded from the council's own resources which mean that there is no requirement to set aside allowances for expected credit losses.
- 7.4 In nearly all cases with service based loans the council has a claim on the underlying assets should the organisation default on the loan.

### **8 Investment Performance Monitoring and Reporting**

- 8.1 The council has delegated responsibility for the monitoring and scrutiny of its investment strategies and activity to the Audit and Accounts Committee.
- 8.2 The execution and administration of the Property Investment Strategy is delegated to the Executive Director of Finance and Resources, supported by the Investment Portfolio Asset Manager who acts in accordance with the council's approved Property Investment Strategy and as a member of The Royal Institution of Chartered Surveyors (RICS) with Standards of Professional Practice.

## Appendix 2

- 8.3 Performance of the council's Property Investment Strategy and associated investments are monitored and scrutinised quarterly by the Audit and Accounts Committee and half yearly by Cabinet.
- 8.4 Performance of the council's investment property portfolio is reported in summary form quarterly to the Audit and Accounts Committee and the income from investment property is monitored and reported as part of the council's revenue budget monitoring.
- 8.5 There is currently no formal monitoring and reporting of the service based investments.

### **9 Capacity, Knowledge, Skills and Culture**

- 9.1 The council employees professionally qualified and experienced staff in senior positions with responsibility for making commercial and service based investment decisions.
- 9.2 For example the Interim Property Manager is a qualified chartered surveyor with 25 years' experience, the Investment Portfolio Asset Manager is a qualified chartered surveyor with 25 years' experience and the Cabinet Member for Property and Development is a chartered surveyor.
- 9.3 The council pays for other staff to study towards relevant professional qualifications including RICS.
- 9.4 Prior to all major investments the council will seek independent advice from external advisors and consultants that are specialists in their field. This approach is more cost effective than employing such staff directly, and ensures that the council has access to knowledge and skill commensurate with its risk appetite.
- 9.5 For property investments the council currently uses Cushman and Wakefield International and for Invest to Grow Fund investments the council is using CBRE.