EASTLEIGH BOROUGH COUNCIL

Investment Strategy Report

2023/24

Contents

Background

The Council invests its money for three broad purposes:

- When the Council 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 (known as service investments);
- To achieve corporate objectives for Regeneration, Service Delivery, Economic, Environmental and Housing Development, or achievement of the Council's Continuous Improvement Strategy, alongside earning investment income, through the purchase and building of property (known as commercial investments)

This Strategy meets the requirements of statutory guidance issued by the Government in 2018 and focuses on the second and third of these investment categories, with the first, Treasury Management Investments being covered in more detail in the 23/24 Treasury Management Strategy report.

Treasury Management Investments

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. 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 (CIPFA).

The balance of Treasury Management Investments is expected to fluctuate between £10M and £60M during the 2023/24 financial year. This is based on the Council having a constant £10M investment in the CCLA property fund, an investment into a pooled fund made to ensure the Council is able to be classified as professional status with its providers of financial services to allow a greater range of services, more information can be found in the Treasury Strategy, alongside having access to one current account and four money market funds, each with an internal investment limit of £10M.

The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Service Investments - Loans

The Council lends money to local residents, employees, businesses and local charities to support local public services and to help the Council achieve its Corporate Objectives, through stimulating local economic growth, regeneration of the local area, and increased provision of affordable Housing.

The largest loan currently forecast is to a Council Subsidiary to accelerate delivery of both housing and infrastructure and seek to increase the percentage of affordable housing on a development. Without this loan the additional community benefit desired by the Council would not have been delivered by the private sector. By providing this loan the Council has helped to meet the corporate objective for an increased provision and a more diverse mix of housing as well as accelerating delivery.

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 the risk and ensure that the total exposure to service loans remains proportionate to both the size and aspirations of the Council, upper limits on the outstanding loans to each category of borrower are detailed in the table below:

Table 1 - Loans for service purposes

Category of Borrower	31/03/2022 Actual			2022/23
	Balance Outstanding £'000	Loss Allowance £'000	Net Figure in Accounts £'000	Approved Limit £'000
Subsidiaries	13,900	0	13,900	13,900
Businesses	3,386	0	3,386	3,386
Local Residents – Mortgages	6	0	6	6
Employees – Loans	85	0	85	30% of employee salary
Total	**17,377**	**0**	**17,377**	

Due to the nature and timing of these loans, the limits will be monitored throughout the year, and should any new loans be identified for approval, limits will be adjusted accordingly and proposed to Cabinet for approval.

Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments. Details of the recovery process are outlined in the Debt Collection Policy and Procedures published on the Council's website.

The Council assesses and mitigates the risk of loss before entering into and whilst holding service loans by:

- assessing the markets in which the Council is looking to invest, to ascertain why the market is currently not delivering the outcomes the Council requires through its Corporate Objectives. If this is due to financial reasons the Council will then assess whether a service loan would provide the means to achieve the desired outcome.

- Upon determining that a service loan may be required, the Council will then seek external advice where necessary, this may include the use of external legal, financial and tax advice as appropriate.

- A credit check and analysis of the beneficiary's financial statements will also be carried out to determine their financial strength. Loans will only be entered into should the beneficiary be of a suitable strength, and additional security may be sought, for instance, through a charge on land, should the Council require this.

- In order to ensure the objectives of the Council are delivered, the terms of the loan may oblige the borrower to meet certain criteria, for instance to deliver a new road to aid congestion before houses are built, or to seek to provide additional affordable housing on a housing development.

- Where possible, the Council will also place a staff member or one of its subsidiaries staff on the board of the project, in order to ensure effective on-going monitoring of the project is maintained.

- Once the loan has been made, the Council will continue to monitor credit ratings and financial statements of the beneficiary to ensure loss adjustments can be made accurately and in a timely manner should the beneficiary's credit rating or financial performance decrease.

Commercial and Housing Investments

The Council invests in commercial and housing investments with the primary intention for regeneration, economic and housing development, either through the direct impact of investments within the Borough, or through the indirect impact of investments within the wider region by providing additional income that is then spent on regeneration, economy, and housing within the local area. A list of the Council's current non treasury Commercial and Service Property and Housing investments can be found at Appendix 3A.

Investments in commercial property and housing follow broadly the same assessment of the risk of loss before entering contractual arrangements by:

- Assessing covenant strength - This includes, but is not limited to, credit checks on potential tenants or strategic partners, meetings with the senior management of potential tenants of large value transactions, a detailed review of their accounting statements, and charges on land where necessary in order to have security over any investment.

- Assessing a thorough financial business case - costing not only the purchase price or amount invested, but also associated long term costs such as future maintenance and void costs. This includes setting aside provisions as follows:

  a) Although the Council predominantly borrows at cheap variable rates, any financial business case is charged at higher long-term rates. This ensures should interest rates rise in the future, the Council has factored in the risk of higher future borrowing costs. An interest rate reserve is held to mitigate against future rate rises affecting the Councils ability to provide services.

  b) The Council also charges a void adjustment to each business case. This reserves a percentage of the income so that when the initial lease period expires, the Council has enough funds set aside to cover the loss of income and void costs such as empty rates for up to 12 months should that tenant decide not to renew a lease, leaving the Council having to find a new tenant. This adjustment is taken to the Property Reserve, an earmarked reserve used to ensure a future loss of tenant does not affect the Council's ability to provide services.

  c) The Council also has a similar maintenance reserve, where, depending on the age and condition of the building, between 5% and 10% of all income is put in reserve each year to cover future maintenance works to the buildings. This Maintenance Reserve is then used to fund the Repairs and Renewals Programme prepared by the Property Services Team.

- Where housing is delivered through one of the Council's housing companies, the provisions for maintenance will have already been taken through a maintenance contract prior to the payment of income to the Council. The Council therefore budgets for and receives, the net income from housing rental income.

- Decisions on property purchases are also subject to additional levels of scrutiny through staff meetings. Discussions will take place between members of Corporate Leadership Team, Asset Management, Strategic Housing, Development Management, Legal Services and Financial Services to scrutinise the due diligence that has been carried out, and to scrutinise financial business cases to ensure potential purchases are sound.

- Once a property has been purchased, the Council will continue to monitor credit ratings and financial statements of the tenant regularly to ensure loss adjustments can be made accurately and in a timely manner should the tenant's credit rating or financial performance decrease.

Proportionality

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 place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium-Term Financial Plan. The Council maintains large reserves to mitigate the impact of any loss of revenue income from its commercial properties, and monitors performance quarterly in order to ensure any possible impact can be identified, controlled and managed as effectively as possible

Table 2 - Proportionality of Commercial Property Income

Proportionality	2020/21 Actual £'000	2021/22 Actual £'000	2024/25 Budget £'000
Gross Service Expenditure	67,506	66,895	64,659
Commercial Property Income	17,640	18,240	19,459
Proportionality of Commercial Property Income	**26%**	**27%**	**30%**

Capacity, Skills and Culture

Staff within Treasury Management will hold quarterly treasury meetings with the Treasury Management Review Group (TMRG). This is a Group consisting of the Leader of the Council, and containing members of the Cabinet, Councillors from the party in power and the opposition parties, alongside senior representation from the Finance Team. The basis of these meetings is for staff to give TMRG an update on the current borrowing and investment position of the Council, as well as to update on upcoming governance changes, legislation and accounting changes, or legal changes that may affect the Council and its investment decision making going forward. This is then followed by questions from the TMRG to further their understanding of the key areas surrounding both investment and borrowing decision making, and to enable them to make informed decisions surrounding Investments.

During 2022/23 the Council held training sessions for all Councillors on Treasury Management and the current borrowing and investment environment, led by our Treasury Advisers, Arlingclose. Another of these sessions will be held in 2023/24. This is a formal training evening, where both staff and advisers brief all Councillors on the current investment position of the Council, future investment position and possible changes to governance that may impact future decisions. A questions and answers session is held after the briefing where Councillors are encouraged to ask questions to both internal staff and Arlingclose to further their understanding of the way the Council makes decisions on both investments and borrowing.

To ensure staff have the correct knowledge and skills to inform investment decisions, the team currently includes:

- A Finance Team with five CIPFA qualified accountants, all with over ten years of experience in Local Government accounting, and one CIMA qualified accountant.

- An Asset Management Team including a number of Chartered Surveyors with over 10 years' experience who are members of the Royal Institution of Chartered Surveyors (RICS), two of which are RICS Registered Valuers. They are regulated by their professional body (RICS) and comply with the RICS rules in relation to conduct and Continuing Professional Development. They maintain their knowledge and skills through regular technical updates from appropriate bodies.

- A Legal Team with 4 qualified solicitors, 2 Chartered Legal Executives, a locum barrister and a trainee Legal Executive and a Trainee Solicitor. This includes 2 with over 10 years in Local Government; 5 with significant property and related commercial transaction knowledge; 3 with extensive planning experience and 3 with substantial regulatory and governance background.

When negotiating commercial deals, there is mandatory representation from both the Council's finance and legal staff in all stages. This is to ensure that both the prudential and legal framework that local authorities operate within is considered. Once it is ensured the Council would be operating within its powers, Finance and Legal representation will stay at the forefront of any decision made, and commercial deals must be approved internally by the Chief Financial Officer (CFO) before being formally approved by Cabinet.

Investment Indicators

The Council has set investment indicators to monitor the future performance of Investments and allow elected councillors and the public to assess the Council's total risk exposure as a result of its investment decisions, and sets them out in the broad categories of Security Risk Indicators, Liquidity Risk Indicators and Yield Risk Indicators

Security

The Council considers a property investment to be secure if its accounting valuation is at or higher than the amount of debt currently outstanding for the asset.

Security Indicator

Commercial and Housing Investments	2021/22 Actual £'000
Asset Valuations	519,753
Debt Outstanding	514,563
Security Value	**5,190**

This indicator returns a positive security value, as the Council has continued to make prudent provision for the repayment of debt, more detail on this can be found in Appendix 3A. This indicator is forecast to improve as the Council's policy on the repayment of debt increases the security value over time, should valuations remain static. This may be affected by external factors as fluctuations in value are common, with the Covid 19 pandemic causing a widespread reduction in valuations.

As the Council has acquired assets, the security value in the initial years after purchase is reduced, as associated costs from the purchase such as stamp duty and professional fees are not included within valuations but remain within the debt outstanding figure. The effect of this is reduced over time due to the Council's policy on the repayment of debt.

The condition of the Council's property portfolio is closely monitored by the Property Services Team, and the cost of maintaining the buildings is covered both by the maintenance reserve seen later in this appendix, as well as through repairing leases, whereby tenants are responsible for keeping the buildings they occupy in good condition.

Where assets are in void, or coming towards the end of a lease period, the Council will carry out a value for money options appraisal on each asset to determine the next course of action. Within these options will be the option to sell the asset to realise a capital receipt, which would be utilised to repay borrowing, and therefore reduce financing costs. This will be balanced against the outstanding borrowing attributed to the property, to allow a comparison to be made between capital gains or losses that could be realised and utilised to reduce borrowing upon sale, versus foregone future revenue income that could be achieved should the property be refurbished, redeveloped, or re-let.

Liquidity

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice. Therefore, to assess liquidity, the Council monitors usable reserve levels that are available for revenue purposes as a percentage of rental income from commercial property.

Liquidity Indicator

Non Treasury Investment income as a proportion of Usable Reserves	2020/21 actual £'000	2021/22 actual £'000	2022/23 forecast £'000
Usable Reserves	43,904	43,673	42,401
Commercial Property Income	17,640	18,240	19,460
Ratio	**40%**	**42%**	**46%**

Commercial Property Yield

The Council monitors property yields both prior to purchase and post purchase and reports on this to both Policy and Performance Scrutiny Panel and Cabinet as part of the Council's quarterly performance monitoring report. As part of an enhanced monitoring regime arising from the Covid-19 pandemic, a report is also taken regularly to the Audit and Resources Committee reviewing property performance.

Yield Indicator

Commercial Property Yield	2020/21 Actual	2021/22 Actual	2022/23 Forecast
Gross Yield	6.23%	5.82%	5.80%

Commercial Investments - Voids and Maintenance

Each purchase by the Council makes allowance for funds to be transferred to reserves at the end of each financial year to cover unforeseen void and maintenance costs. To ensure these reserves are maintained to the correct level, balances will be regularly reported as part of the Prudential Indicators. These balances will also be monitored through the Medium-Term Financial Plan and Budget setting processes, and both overall balances of these reserves, and individual property balances will be assessed to ensure they continue to provide an appropriate level of risk management.

Void and Maintenance Reserve Indicator

Property Reserves	2020/21 Actual £'000	2021/22 Actual £'000	2022/23 Budget £'000
Void Reserve	2,553	2,931	1,875
Maintenance Reserve	1,072	1,406	1,739
Total Reserve	**3,626**	**4,337**	**3,614**

Commercial Investments – Vacancy Levels

Monitoring vacancy levels (voids) indicates whether the property portfolio is being managed effectively (including marketing and tenant relations) to ensure the portfolio is as productive as possible.

Vacancy Level Indicator

Vacancy Levels	2019/20 actual	2020/21 actual	2021/22 actual
Square Footage Vacant	3298 Sq Feet	10,249 Sq Feet	57,786 Sq Feet
% of lettable properties	0.32%	1.00%	4.82%