

Decision Report – Cabinet
 Decision Date – 18th December 2019

Investment Strategy

Cabinet Member(s): Cllr Mandy Chilcott – Cabinet Member for Resources
 Division and Local Member(s): All
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	Seen by:	Name	Date
	County Solicitor	Honor Clarke	12/12/2019
	Monitoring Officer	Scott Wooldridge	12/12/2019
	Corporate Finance	Sheila Collins	12/12/2019
	Human Resources	Chris Squire	12/12/2019
	Property	Paula Hewitt / John Cooper	12/12/2019
	Procurement / ICT	Simon Clifford	12/12/2019
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	Local Member(s)	All	12/12/2019
	Cabinet Member	Cllr Mandy Chilcott	12/12/2019
	Opposition Spokesperson	Cllr Liz Leyshon	12/12/2019
	Relevant Scrutiny Chairman	Cllr Anna Groskop for Scrutiny Place	12/12/2019
Forward Plan Reference:	FP/19/10/13		
Summary:	This report outlines the three options available to the Council to make investments and generate a financial return to support the delivery of council priorities. Those options are the investment of surplus cash through our Treasury Management activities, further investment in property assets that the council already owns and the purchasing of new		

	<p>property assets. Considering the risks, returns and ease of implementation the Council propose to focus initially on generating increased revenue returns through the current Treasury Management Portfolio. It is forecast that a more diversified approach to investments could lead to additional income of over £1m over the next two years.</p> <p>The Council will also actively explore options for further investment in property that it already owns. The current governance and delegation arrangements that are in place for the Council’s Treasury Management Strategy and Financial Regulations, are robust and fit for purpose and do not need to be changed. For clarity, the responsibility for determining the precise timing of any investment and the decision about which fund to invest in is currently delegated to the Section 151 Officer to enable timely decision making.</p> <p>An investment strategy of actively purchasing new property assets for financial return involves risk that requires additional due diligence and strengthened governance arrangements.</p>
<p>Recommendations:</p>	<p>It is RECOMMENDED that the Cabinet endorses and recommends that Full Council agrees to:</p> <ol style="list-style-type: none"> 1. Build on its current Treasury Management investment activities to generate higher returns, protect against inflationary risks, sustaining a prudent balance of risk and reward. 2. Pro-actively consider options for further investing in existing Council owned property to optimise the value from these assets. 3. Consider other investment opportunities that may arise from time to time subject to appropriate due diligence and governance arrangements being in place.
<p>Reasons for Recommendations:</p>	<p>To ensure suitable governance arrangements are in place for any investment decisions including transparency, risks and returns.</p>
<p>Links to County Vision, Business Plan and Medium-Term Financial Strategy:</p>	<p>The Medium-Term Financial Strategy includes proposals to build upon Treasury Management investment activities.</p>

Consultations and co-production undertaken:	None.
Financial Implications:	By building on the approach to Treasury Management investments, it is expected that there will be increased income which can be built into the 2020/21 Budget.
Legal Implications:	<p>The Local Government Act 2003 requires the Council to operate the overall treasury function regarding the CIPFA Code of Practice for Treasury Management in the Public Services. The Code requires Full Council to receive as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report. The Council complies with these requirements.</p> <p>The Secretary of State issued statutory guidance in 2018 regarding 'Local Government Investments' which came into effect from 1 April 2018.</p> <p>The definition of an investment covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations. The guidance applies to all local authorities, who hold or during the next financial year intend to hold financial or non-financial investments, solely or in part to generate revenue income.</p> <p>For each financial year, a local authority should prepare at least one Investment Strategy. The Investment Strategy needs to be approved by the Full Council prior to the start of the financial year.</p> <p>Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Investment Strategy can be published in those documents.</p>
HR Implications:	There are no HR implications arising directly from this report.

Risk Implications:	The risks associated with Treasury Management are dealt with in the Annual Treasury Management Strategy, Annual Investment Strategy, and Treasury Management Practice documents.
Other Implications (including due regard implications):	<p><u>Equalities Implications</u> There are no specific equalities implications arising from the contents of this report.</p> <p><u>Community Safety Implications</u> There are no community safety implications arising from the contents of this report.</p> <p><u>Sustainability Implications</u> There are no sustainability implications arising from this report.</p> <p><u>Health and Safety Implications</u> There are no health and safety implications arising from this report.</p> <p><u>Privacy Implications</u> There are no privacy implications arising from this report.</p> <p><u>Health and Wellbeing Implications</u> There are no health and wellbeing implications arising from this report.</p>
Scrutiny comments / recommendation (if any):	<p>The Audit Committee is the nominated body to provide scrutiny for Treasury Management.</p> <p>In addition, the established reporting to the Cabinet and Full Council on the proposed Annual Treasury Management Strategy and mid-year review provide opportunities for all members to scrutinise performance and risk management.</p>

1. Background

1.1 In the 2019-22 Capital Strategy (Investment Strategy) report to the Cabinet and County Council meetings in February 2019, the possibility of investing £100m for financial gain was identified as an option to be explored pending the appropriate strategy and governance being put in place. The proposed approach was subject to approval by the Cabinet and County Council.

1.2 The introduction of Prudential Code lifted the restrictions on local authority borrowing and allowed authorities the local freedom to borrow provided they could afford the repayment costs. This has provided local authorities with significant freedoms and with the reductions in funding has seen significant borrowing by several councils in order to purchase new properties for purely commercial returns.

2. Updates and Changes to the landscape

2.1 The National Audit Office and the Public Accounts Committee have recently raised several concerns about some of the investment activity by councils where they have been borrowing to purchase various property assets. They have suggested that some local authorities are exposing themselves to too much financial risk through borrowing and investment decisions in relation to their sizes. There is a concern that some are not providing enough transparency around their activities and decision-making processes. There is also a concern that there may not be enough expertise to fully understand the complex transactions that they are approving.

2.2 External Auditors are also looking at the accounting treatments adopted by some councils and have raised issues around the approaches of not including Minimum Revenue Provision (MRP) costs in the accounts. If these costs were included, then some of the Business Cases would not provide a sensible return or would be very marginal for the risks involved.

2.3 The Public Works Loan Board (PWLB) is the main source of funding for local authority borrowing and is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.

2.4 On 9th October 2019, HM Treasury, without warning, imposed a 1% premium on all loans from the PWLB. Within the letter to all Local Authority Chief Finance Officers, it cited the following:

"Some local authorities have substantially increased their use of the PWLB in recent months, as the cost of borrowing has fallen to record lows. HM Treasury is therefore restoring interest rates to levels available in 2018, by increasing the margin that applies to new loans from the PWLB by 100bps (one percentage point) on top of usual lending terms".

"This restoration of normal PWLB lending rates will apply to all new loans with immediate effect. The Government will monitor the impact of this change and keep rates policy under review".

2.5 The increase in rate obviously reduces the potential returns from any new investments and has a negative impact upon any business case. This combined with some auditor concerns how some councils have accounted for the repayment costs (MRP) has meant that the financial returns from new property purchases are now very marginal for the risks involved. The rate change has already been an impact with a significant reduction in local authority borrowing.

3 Treasury Management

3.1 The Council invests its surplus cash through its Treasury Management investments processes which are well established and heavily governed. Full Council approves the Treasury Management Strategy Statement on an annual basis, and this sets out the range and limits of the investment and borrowing activity. The day to day decision making is delegated to the Section 151 Officer who must comply with the limits set out in the Treasury Management Strategy and provide members with an update on treasury management activities during the year.

3.2 A key principle in Treasury Management is to protect the Council's assets so this involves assessing the risks of each investment. To help do this the Council has appointed Arlingclose as its Treasury Advisors who provide regular updates on the credit risks as well as advice on the Treasury Strategy.

3.3 One of the key risks to the Council's Treasury Management Portfolio is the loss of capital value if the return on investments is below inflation. The returns from the investment portfolio have fallen below inflation and to help mitigate against this the Council began a programme to diversify. In 2017 a £10m investment into the CCLA property fund was made with the intention of making further longer-term strategic investments of this type in due course. The returns from this investment have consistently been above inflation at around 4% per annum. The current approved Treasury Management Strategy and associated limits are sufficient to enable further similar investments without additional decisions. The responsibility for determining the precise timing of any investment and the decision about which fund to invest in is delegated to the Section 151 Officer to enable timely decision making. Ahead of any decision, the Section 151 Officer will take the usual advice from the councils external treasury advisors Arlingclose. One of the key objectives will be to achieve a higher return than that which is currently being achieved by short term investments in banks, Money Market Funds and other local authorities by taking a more longer-term view and trying to achieve a more diversified portfolio of investments.

3.4 By achieving a higher return on investments, the Council will protect itself against inflationary risk and the devaluing of its cash assets. Based upon current cash flow projections it is estimated that the Council's strategic investments could be increased from the current level of £10m (that is currently invested with CCLA) to around £60m. This strategy of increasing our Strategic Investments and reducing our short-term investments would generate an additional income of over £1m over the next 2 years. Taking this approach will expose the Council to risks on the capital values of the investment but these will only be realised if the investments are sold and the intention is to hold these investments for the longer term.

3.5 The existing governance arrangements around Treasury Management Activity are strong and robust and therefore no changes are needed to these for decision making purposes. The 2020/21 Treasury Management Strategy Statement will be considered by Cabinet and Full Council in February and will set out both the level of Strategic Investments and the different types of investments that will be used to deliver a more diversified portfolio.

4 Investing in Property that the Council already owns

4.1 The Council is ambitious to optimise the value from property assets that it currently owns and will consider opportunities to invest in these properties to generate either a higher sales value (capital receipt) if the property is surplus to service needs, or to generate an on-going income stream for the Council. For these properties, that is ones the council already owns, developing firm proposals to enhance value will likely be timelier than for any property the council would need to purchase.

4.2 The decision to invest will be considered through the usual process for capital schemes with a report to Cabinet and will be considered against the other priorities and competing capital schemes. The Business Case will need to clearly demonstrate that it works financially and the higher sales value or increased income more than cover the borrowing costs.

4.3 If approved the scheme will be added to the Capital Programme and the costs of the scheme will be reported through the usual quarterly Capital Programme monitoring reports to members. The borrowing costs and increase income will be included in the Medium-Term Financial Plan and monitored through the usual monthly budget monitoring reports to Cabinet and Scrutiny.

5 Purchasing New Properties for Investment Returns

- 5.1 For the Council to consider an approach of a major investment programme for purchasing new properties that generate a financial return it would need to create an Investment Strategy which set out the following:
- Criteria for which 'properties' to invest in, including specification of the balance / mix of a portfolio (i.e. asset types), and;
 - Clear governance arrangements and democratic accountability ensuring transparent and open decision making and rigorous due diligence (property, legal, financial).
- 5.2 It would be essential that appropriate governance arrangements were put in place to ensure that there is robust appraisal of any potential investments that may be made. Examples of the type of arrangements that may be considered include:
- Investment Board – comprising members, officers and professional advisers (as required) to review and provide views on potential investment decisions to be undertaken by either the Cabinet Member for Resources or the Section 151 Officer. This Board would need to meet regularly for the Cabinet Member or Section 151 Officer to be able to act swiftly on any opportunities presented to the Board
 - Gateway process – to determine whether to pursue a proposal. Clear criteria need to be pre-determined and rigorously applied
 - Cabinet / Cabinet Member for Resources / Section 151 Officer approval – the Council's constitution (Cabinet Scheme of Delegation) would need amending to clarify the proposed decision-making arrangements and any limits or internal consultation requirements prior to the exercise of delegated powers.
- 5.3 Depending on the property assets that the Council might be invested in it may be necessary to have a:
- Shareholder Board - comprising members and professional advisers to ensure effective oversight of the property portfolio and alignment with corporate priorities;
 - 'Property' Company – 'arms-length' company would be required to make any investments in properties for financial gain (rather than economic prosperity).
- 5.4 Some of the principal risks that the Council would need to address in formulating its approach to non-treasury investments are:
- Failing to identify realistic net gains – being over-ambitious could lead to investments with an inappropriate level of risk
 - Some investments will not pay back immediately, requiring an investment approach which is affordable in cash-flow terms
 - Not setting out clear parameters for investment areas (e.g. retail, commercial, residential portfolio mix)

- An inability to secure adequate commercial skills / resources to advise on the investment options
- Allowing insufficient time to set up rigorous due diligence, governance and transparent democratic accountability
- Not establishing 'smart' democratic processes to ensure investments can be approved at pace.

5.5 Considering the above, the recent restrictions that government have put in place, which means that any assets that are purchased must be within the 'economic area' of Somerset, and the additional costs of borrowing following the rate rise by the PWLB means that this route is now less attractive and more restricted. The experience from other councils shows that were we to actively undertake significant programme of activity in this area, the existing governance arrangements would need to be strengthened.

5.6 This however does not stop the Council from taking advantage of any opportunities that may arise from time to time. Such opportunities will be subject to appropriate due diligence with a full business case including the full costs, returns and risks and can be considered within the existing governance framework.