Appendix C

# Investment Strategy Report 2019/20

## Introduction

The Authority can invest its money for three 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 support local public services by lending to other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

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

## 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 is expected to fluctuate between £48m and £57m during the 2019/20 financial year.

**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 2019/20 for treasury management investments are covered in Appendix A of this report.

## Service Investments: Loans

**Contribution:** The Authority from time to time may lend money to local businesses, local charities or housing associations to support local public services and stimulate local economic growth.

The only service loan that the Council currently has outstanding is a £250,000 start-up loan that was made to the Derbyshire Building Control Partnership during the 2017/18 financial year. The Authority is a shareholder in the company, along with 5 other Derbyshire Local Authorities.

**Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due.

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments. In the case of the loan to the Derbyshire Building Control Partnership each of the 5 other shareholders have guaranteed 1/6$^{th}$ of the loan, therefore the Council's maximum loss is limited to £41,666.

**Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding service loans, on a case by case basis. A thorough examination of the borrowers' accounts and/or business plans is undertaken by the Head of Finance and Resources. The services of external advisors will be sought for any areas requiring specific expertise.

## Commercial Investments: Property

**Contribution:** The Council owns local industrial and commercial properties which are held primarily for service purposes such as economic regeneration, but which in addition generate a profit that will be spent on local public services. These properties can be split into three main categories: industrial units and trading estates, retail and office and undeveloped land. The majority of these properties have been held for a substantial period of time, more than 30 years in the case of some assets.

*Table 1: Property held for investment purposes in £ millions*

| **Type of Property** | **Value in accounts 31.03.2018** |
|---|---:|
| Industrial Units and Trading Estates | 18.3 |
| Retail and Office | 17.4 |
| Undeveloped Land | 10.5 |
| **TOTAL** | **46.2** |

**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 / construction cost.

A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2018/19 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

**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. As the main purpose of owning these properties is for service reasons, the Authority does not need to rely on selling these assets for investment purposes, for example  to repay capital borrowed.

**Income:** The Authority is dependent on profit generating investment activity to achieve a balanced revenue budget. The net amount of investment income (after operating expenses) received in 2017/18 was

£2.6m, this equated to 3.9% of all general fund income received and a similar amount is budgeted for in 2019/20. Income received is monitored on a regular basis and any expected shortfall would be reported in the revised budget

**Risk assessment of future commercial investments:** The Director of Finance and Resources will assess the risk of loss before entering into and whilst holding commercial property investments. Due consideration will be given to the risks relating to failure to create income/exposure to market changes, ongoing maintenance/management of the asset, possibility of arrears and exposure in one sector or locality. External advice will be sought for any investments requiring specific expertise.

Commercial property investments will be subject to a minimum expected yield of 10% and it must be demonstrated that the level of risk is acceptable for the expected yield by benchmarking against alternative investment products. Full contingency plans are required to be in place before entering into any commercial property investments, in the event that the investment will fail to meet the expected yield.

## Capacity, Skills and Culture

**Elected members and statutory officers:** All investment and commercial decisions will be taken with the involvement of the Director of Finance and Resources, who will ensure that all elected members and other officers are fully aware of the risks involved and how the decision could change the overall risk exposure of the Authority. All decisions made will also have regard to the principles of the prudential framework and of the regulatory regime in which local authorities operate.

## 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.

*Table 2: Total investment exposure in £millions*

| Total investment exposure | 31.03.2018 Actual | 31.03.2019 Forecast | 31.03.2020 Forecast |
|---|---|---|---|
| Treasury management investments | 46.4 | 45.6 | 44.0 |
| Service investments: Loans | 0.25 | 0.2 | 0.15 |
| Commercial investments: Property | 46.2 | 46.2 | 46.2 |
| TOTAL EXPOSURE | 92.85 | 92.0 | 90.35 |

**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. The Authority does not have any investments that could be described as being funded by borrowing. All of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

**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.

*Table 3: Investment rate of return (net of all costs)*

| Investments net rate of return | 2017/18 Actual | 2018/19 Forecast | 2019/20 Forecast |
|---|---|---|---|
| Treasury management investments | 0.84% | 0.73% | 0.93% |
| Service investments: Loans | 4.85% | 4.85% | 4.85% |
| Commercial investments: Property | 5.64% | 5.64% | 5.64% |