

# Cherwell District Council

## Investment Strategy 2020/21

### 1 Introduction

- 1.1 The council invests 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 or buying shares in other organisations (**service investments**), and
  - to earn investment income (known as **commercial investments** where this is the main purpose).
- 1.2 The investment strategy was a new report introduced 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.

### 2 Treasury Management Investments

- 2.1 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. The balance of treasury management investments is expected to be an average of £15m during the 2020/21 financial year.

#### **Contribution**

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

#### **Further details**

- 2.3 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.

### 3 Service Investments: Loans

#### **Contribution**

- 3.1 The council lends money to its subsidiaries, local parishes, the local Business Improvement District, and local charities to support local public services and stimulate local economic growth. The main loans issued are to the council's subsidiaries – the Graven Hill Village companies and Crown House Banbury Ltd.

Graven Hill is an ambitious self-build housing development providing significant housing in Bicester. Crown House is redeveloping a derelict building in the centre of Banbury which will provide significant rental opportunities in the town centre while removing an eye-sore.

### Security

- 3.2 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 this risk, and ensure that total exposure to service loans remains proportionate to the size of the council, upper limits on the outstanding loans to each category of borrower have been set as follows:

*Table 1: Loans for service purposes in £ millions*

Category of borrower	31.3.2019 actual			2020/21
	Balance*	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries	46.800	0.593	46.207	83.287
Local charities	1.152	0.049	1.103	1.150
Local Business	0.020	0	0.020	0.050
Parishes	0.094	0	0.094	0.100
<b>TOTAL</b>	<b>48.066</b>	<b>0.642</b>	<b>47.424</b>	<b>84.587</b>

\* including accrued interest

- 3.3 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 from 2018/19 onwards will be 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.

### Risk assessment

- 3.4 The council assesses the risk of loss before entering into and whilst holding service loans by approaching each loan request individually. The bulk of the council's loans are to its subsidiaries. When the council considers whether or not to create or acquire a subsidiary a full business case is prepared which sets out the optimal financing of the company. This will include an assessment of the market in which it will be competing, the nature and level of competition, how that market may evolve over time, exit strategy and any ongoing investment requirements. External advisors are used where appropriate to complement officer expertise and second opinions from alternate advisors is sought in order to monitor and maintain the quality of advice provided by external advisors.
- 3.5 Other service loans are evaluated against a set of criteria designed to demonstrate:

- Evidence of project objectives and needs analysis is provided
- The loan must have a demonstrable community impact
- The loan would provide up to 50% of the whole project cost
- Such a loan can only be applied for by constituted voluntary organisations with their own bank account; Town or Parish councils; charitable organisations
- The loan cannot be applied retrospectively
- The applicant has provided evidence of its financial stability and of its ability to manage the proposed scheme
- The applicant has demonstrated that the proposed scheme has been developed following good practice in terms of planning, procurement and financial appraisal
- The applicant has provided evidence the affordability of their proposed scheme and the loan repayments
- That the project furthers the council's priorities as reflected in its Business Plan

#### 4 Service Investments: Shares

##### Contribution

- 4.1 The council invests in the shares of its subsidiaries to support local public services and stimulate local economic and housing growth. The council currently holds shares in Graven Hill Holding Company Ltd and Crown House Banbury Ltd.

##### Security

- 4.2 One of the risks of investing in shares is that they can fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

*Table 2: Shares held for service purposes in £ millions*

Category of company	31.3.2019 actual			2020/21
	Amounts invested	Gains or losses	Value in accounts	Approved Limit
Subsidiaries	22.828	0	22.828	26.971
<b>TOTAL</b>	<b>22.828</b>	<b>0</b>	<b>22.828</b>	<b>26.971</b>

##### Risk assessment

- 4.3 The council assesses the risk of loss before entering into and whilst holding shares by maintaining close links with the boards of directors of the companies through an established Shareholder Committee. Risk is assessed as above in Service Loans.

##### Liquidity

- 4.4 The maximum periods for which funds may prudently be committed are assessed on a project by project basis. The decision will balance both the long term viability of the subsidiary and the revenue and capital requirements of the council.

#### **Non-specified Investments**

- 4.5 Shares are the only investment type that the council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the council's upper limits on non-specified investments. The council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

### **5 Commercial Investments: Property**

#### **Contribution**

- 5.1 The council invests in local commercial and residential property with the intention of making a profit that will be spent on local public services. The portfolio comprises a cross section of retail, office and industrial assets together with a health centre. The four largest investments are as follows:

- Castle Quay, Banbury; a covered shopping centre and development site
- Pioneer Square, Bicester; a modern retail parade of shops
- Franklins House, Bicester; a mixed use complex comprising offices, hotel, business centre and public library
- Tramway Industrial Estate

- 5.2 These assets contribute an aggregate £5.1m gross income to the council's revenue budget. They are all town centre properties and afford the council an opportunity to influence the amenity and environment of its two principal strategic centres. Castle Quay will, in particular, allow the development of a new leisure orientated focal point to help revitalise Banbury town centre.

The component parts of the entire investment portfolio are described below:

Table 3: Property held for investment purposes in £ millions0

Property	Actual	Actual	31.3.2019 actual		31.3.2020 expected	
	Closing Balance 2017/18	Purchase / Build Costs 2018/19	Gains or (losses)	Value at 31.3.19	Gains or (losses)	Value in accounts
Castle Quay Shopping Centre	61.120	0	-18.695	42.425	0	42.425
Pioneer Square	8.026	0.135	-0.108	8.053	0	8.053
Tramway Industrial Estate	0	9.603	-0.383	9.220	0	9.220
Other properties valued under £5m	11.725	0.242	0.575	12.542	0	12.542
<b>TOTAL</b>	<b>80.871</b>	<b>9.980</b>	<b>-18.611</b>	<b>72.240</b>	<b>0</b>	<b>72.240</b>

### Security

- 5.3 In accordance with government guidance, the council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.
- 5.4 A fair value assessment of the council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2019/20 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.

### Risk assessment

- 5.5 The council assesses the risk of loss before entering into and whilst holding property investments by cash flow modelling the income and expenditure profile of each investment and interrogating that model across a range of scenarios to test the robustness of the investment. The modelling exercise is informed by the likelihood of tenant default and the chances that individual units will become empty during the hold period.
- 5.6 The property investment market is dynamic and we are kept abreast of developments by frequent communication and established relationships with local and national agents, supplemented by in-house investigations and reading of published research. The market is at present competitive in most asset sectors and our focus is on assets that are local, strategic and meet our investment return criteria. We are mindful of the council's need for a reliable future income streams and occupational demand is fundamental to our appraisals as longer let assets tend not to generate sufficiently attractive returns.

- 5.7 In all acquisitions we take external advice from acknowledged experts in the field and sense-check their input against our in-house knowledge, experience and expertise. The advice sourced covers market value but also, given the purpose of the investment, letting risk, marketability and occupational demand, and likely expenditure over the hold period.
- 5.8 The council uses a number of local and national advisors and cross reference their views periodically. There is no single party who expects to be instructed by the council without competition.
- 5.9 Credit ratings are used on acquisitions, new lettings and when tenants request consent to assign their leases. The council uses D&B ratings and also study published accounts.
- Credit ratings have not historically been used to monitor existing tenants but this will be introduced for our largest tenants this year.
- 5.10 A number of other strategies are used to mitigate risk:
- Tenant rent payment histories are analysed on any acquisition.
  - Tenant rent payment patterns and arrears are examined in the existing portfolio.
  - Introducing agents advise the council throughout the acquisition process and their advice includes market commentary at a national and a local level and commentary on perceived risks to the investment.
  - In tandem with the above every acquisition is subject to a third party valuation by national surveyors who are independent i.e. not acting for the council or the vendor on the acquisition.

### **Liquidity**

- 5.11 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 council acknowledges illiquidity as a risk in property and whilst it cannot be avoided the risk is mitigated by the following strategies:
- The council invests across a range of sectors. Illiquidity is to an extent fluid and at any given time varies across sectors. This allows the council the opportunity to effect sales, if required, in the more liquid sectors
  - The council's assets are likewise diversified in terms of lot size. This affords the council the ability to access a range of purchaser types e.g. small local investors, listed property companies or institutions
  - The council does not invest in high risk assets which can be the most illiquid of all
  - The council's investments are not what is termed 'Investment Grade', but they are fundable – i.e. if sold they could be suitable for debt backed investors
  - The council does not invest in specialist properties, where the market tends to be most illiquid
  - The council's assets are uncharged. It is often lenders who require assets to be sold and whilst gearing does not increase illiquidity per se, it can expose an owner to greater risk of selling an illiquid asset at an inopportune time

## 6 Loan Commitments and Financial Guarantees

- 6.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the council and are included here for completeness.

The council has contractually committed to the following loan amounts which have yet to be drawn upon (as at 11/11/19):

*Table 4: Loan Commitments and Guarantees*

<b>Borrower</b>	<b>Purpose</b>	<b>£m Contractually Available</b>
Crown House Banbury Ltd	Redevelopment of town centre building into housing	0.6
Graven Hill Village Development Company Ltd	Revolving Credit Facility available to the council's subsidiary until 2026	13.5
Graven Hill Development Company Ltd	Facility Agreement that has been in place since 2014 to deliver the project.	19.8
Graven Hill Development Company Ltd	Loan Note instrument to enable the company to deliver its objectives	7.9
<b>TOTAL</b>		<b>41.8</b>

## 7 Capacity, Skills and Culture

### **Elected members and statutory officers**

- 7.1 The majority of senior statutory officers are qualified to degree level and have appropriate professional qualifications. Their shared business experience encompasses both the public and private sectors and the three most senior Property & Investment team members have on average 20+ years commercial experience.

Training and guidance are provided to support members in delivering their roles and support effective decision making.

### **Commercial Investments**

- 7.2 Negotiations are either undertaken directly by Assistant Directors or at a senior level with Assistant Director direct involvement and oversight, alongside input from Directors

and Lead Members where required. Assistant Directors are aware of the regulatory regime and convey that to all junior staff.

### Corporate governance

- 7.3 There are appropriate corporate governance measures in place which comprise end to end decision making procedures. These include risk assessments within the organisation; presentation to relevant committees including Members, statutory officers approvals and relevant project boards. The annual Corporate Investment Strategy [insert link when available] provides the reference point against which investment decisions are undertaken.

## 8 Investment Indicators

- 8.1 The council 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

- 8.2 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 and guarantees the council has issued over third party loans.

*Table 5: 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	15.3	15.0	15.0
Service investments: Loans	47.4	51.4	51.4
Service investments: Shares	22.8	27.8	27.8
Commercial investments: Property	72.2	72.2	140
<b>TOTAL INVESTMENTS</b>	<b>157.7</b>	<b>166.4</b>	<b>234.2</b>
Commitments to lend	1.8	36.4	34.0
<b>TOTAL EXPOSURE</b>	<b>159.5</b>	<b>202.8</b>	<b>268.2</b>

### How investments are funded

- 8.3 Government guidance is that these indicators should include how investments are funded. The council's investments are funded by usable reserves, income received in advance of expenditure and borrowing.



**Rate of return received**

- 8.4 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 6: Investment rate of return (net of all costs)*

<b>Investments net rate of return</b>	<b>2018/19 Actual</b>	<b>2018/19 Forecast</b>	<b>2019/20 Forecast</b>
Treasury management investments	0.50%	0.70%	0.68%
Service investments: Loans	1.5% - 12%	1.5% - 12%	1.5% - 12%
Commercial investments: Property	Variable	Variable	Variable