City Council Decision

Investment Strategy 2022/23

Decision to be taken by: City Council

Overview Select Committee: 10th February 2022

Council: 23rd February 2022

Lead director: Alison Greenhill,

Chief Operating Officer

Useful information:

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- Report authors: Amy Oliver
  Nick Booth
- Author contact details: amy.oliver@leicester.gov.uk
  Nick.booth@leicester.gov.uk

1. Purpose of Report

1.1 This strategy defines the Council's approach to making and holding investments, other than those made for normal treasury management purposes. The latter are described in the annual treasury management strategy.

1.2 The strategy is essentially the same as Council approved last year.

2. Summary

2.1 Government guidance requires the Council to approve an investment strategy. This requirement has arisen because of Government concerns about some authorities borrowing substantial sums of money to invest in commercial property (sometimes a multiple of their net revenue budget).

2.2 The requirement to have an overarching investment strategy was introduced from 2019-20 onwards, so this is the fourth such report.

2.3 For the purposes of this strategy, an investment means any spending, or any interest-bearing loan to a third party which is (at least in part) intended to achieve a return for the Council. It includes advances made to the Leicester and Leicestershire Enterprise Partnership (LLEP) for their purposes, if the Council expects to make a return on the money.

2.4 The Council also invests in pooled property funds. These are funds where large numbers of investors own a part share in a large number of properties, and are professionally managed. Our policy for investment in pooled funds is described in the treasury management strategy, rather than this strategy.

2.5 The strategy excludes investment in new Housing Revenue Account (HRA) dwellings, as this is not done to achieve a return.

3. Recommendations

3.1 Members of Overview Select Committee are recommended to note the report and make any comments to the Chief Operating Officer as wished, prior to Council consideration.

3.2 The Council is recommended to approve this Investment Strategy.

4. **Current Investments**

4.1 The Council has approved the following investments which fall within the remit of this strategy.

(a) The Corporate Estate. The purpose of holding the portfolio includes income generation, but also with an eye to providing a range of accommodation for businesses and for ensuring a presence in city centre retail. The properties in the fund are not held to provide accommodation or services to/for the Council. Accounting rules do not require us to treat the properties as investment properties for reporting purposes: however, they are held in part for return and thus fall within the ambit of this strategy. As of 31st March 2021, the portfolio included 374 properties and 1,151 lettable units which were available for commercial lease. It includes industrial units, shops, and other business premises located in the city with some agricultural holdings outside. Much of the estate has been owned by the Council for decades. The total value of the portfolio was estimated as of 31st March 2021 to be £112.8m and all purchases have been fully financed (i.e. there is no outstanding debt). Gross rental income for 2020/21 was £7.48m and the annual contribution to the General Fund was £5.35m. During 2021/22, the Council acquired the Haymarket Shopping Centre for £10 million which should add to these figures when the next valuation of the Corporate Estate is undertaken as of the position on 31st March 2022.

(b) A loan to Leicestershire Cricket Club of £2.45m, to enable the Club to improve its facilities at an interest rate of 5%. The loan is supported by guarantees from the English Cricket Board and repayments are up to date. At the time of writing, £2.3m remains outstanding.

(c) A loan of £1.5m to Ethically Sourced Products Ltd. (of which just under £1.3m remains outstanding). This loan carries a return equivalent to 4% per annum and is due to be repaid by 2025. Repayments of this loan were suspended at the outset of the Covid crisis in 2020, but have now resumed and are up to date.

(d) £10.4m has been spent (with £8.4m prudential borrowing) to fund a hotel development at the Haymarket Shopping Centre and improvements to the lifts and car park, for which the Council has received a revenue generating lease. Expenditure on the scheme is now complete. Income in 2021/22 is expected to be £237k rising to £284k p.a. thereafter.

(e) The Council has also incurred expenditure of £5.3m to deliver 26,400 sq. ft of workspace at Pioneer Park. The scheme has attracted £2.15m of external funding. Prudential borrowing is expected to be £1.7m on the scheme. The medium-term impact on the Council's revenue budget was expected to result in a net surplus of approximately £100k p.a. but early indications after it opened are positive so the net surplus may actually be slightly better.

4.2 LLEP manages the "Growing Places Fund" which makes loans to businesses and other organisations for economic development. The total amount available is c.£12m. This fund does not come within the remit of this investment strategy, as the City Council has no financial exposure. (The original capital was provided by the Government, and there is now a revolving fund of new loans made as old loans are repaid. If there are defaults on the old loans, the fund simply stops revolving). The Council may seek LLEP's agreement to use the fund jointly with City Council loan funding, which helps mitigate risk.

4.3 A good example of a successful outcome was a loan of £4m made to support the relocation of Hastings Insurance to premises next to the railway station which was fully repaid in 2018/19. Interest of £0.6m was paid on top of the outstanding capital sum (equivalent to 10% per year) and Hastings increased the number of jobs in Leicester to 1,000.

5. The Council's Overall Approach

5.1 The Council facilitates investment which enables us to reduce reliance on returns from cash (the treasury management strategy) and at the same time put to use sums to benefit the people of Leicester. However, the Council acknowledges the risk associated with such investment, and will ensure it is not left hostage to changing market fortunes.

5.2 The Council is prepared to take greater risks in the furtherance of this strategy than it would be with the treasury management strategy: this is because investment will never take place <u>primarily</u> to generate a financial yield.

5.3 The Council's priorities for investment are:-

(a) Security of capital – notwithstanding the above, this is the paramount consideration;

(b) Yield (the return on investments) - this is important, but secondary to ensuring our capital is protected;

(c) Liquidity (ability to get money back when we want it) – this is the lowest priority, and the Council accepts that such investments are less liquid than treasury management investments. We can live with this, because individual investments are small scale compared to the overall size of the Council. We have other (treasury) investments which are kept for liquidity: these exceed the value of our external debt.

5.4 Property acquired under this investment strategy will be located:-

(a) In the case of the Corporate Estate, within the boundary of LLEP (usually, within the city);

(b) If acquired for economic regeneration purposes, within or at the perimeter of the LLEP area;

(c) If acquired for other reasons, normally within the city boundary, but may be elsewhere to better meet service objectives (for example, an investment in solar farms – the key consideration being best value from the site regardless of location; we may also join a consortium of other authorities to invest in facilities which serve all our purposes).

5.5 Individual investments can be funded by any of the following (or combination of the following):-

(a) Grants/contributions from third parties (including LLEP) where the funding is provided at the third party's risk;

(b) Capital or revenue monies held by the Council;

(c) Prudential borrowing, and contributions from third parties where the Director of Finance deems the substance of the investment to be at the Council's risk (e.g. income strips). In practice, "prudential borrowing" is unlikely to require genuine external borrowing as we have sufficient cash balances (as described in the treasury management strategy). Prudential borrowing is best seen as a permission to borrow externally, should we need to. This category includes prudential borrowing in anticipation of future business rates growth in Enterprise Zones.

5.6 Items (b) and (c) together represent the Council's capital invested. Item (c) represents the risk of the Council requiring further capital or revenue resources if an investment fails; it may or may not represent any actual external debt. The amount of prudential borrowing outstanding may fall over the life of an investment. The totality of prudential borrowing, or other funding provided at the Council's risk, outstanding at any one time is a key control over the Council's investment activity and is termed "exposure".

5.7 The Council will not, at any one time, have exposure in excess of the following:-

	£m
On commercial or industrial property it already owns or will own.	100
For loans to third parties	20
To fund Enterprise Zone projects	30
For other investments	40

5.8 The Council will not have more than £130m of exposure in respect of all activity covered by this strategy. Thus it is not possible to reach the maxima in all the above categories.

5.9 Limits on total external debt are included in the treasury management strategy.

5.10 The Council can reduce its exposure, particularly if an investment is performing poorly, by writing down prudential borrowing using capital or revenue resources.

5.11 Where the Council has an option of utilising third party contributions at the Council's risk, the Director of Finance will determine whether or not this represents value for money as an alternative to prudential borrowing.

6. What we invest in and how we assess schemes

6.1 Decisions to invest will be taken in accordance with the usual requirements of the constitution. Executive decisions will be subject to normal requirements regarding notice and call-in. All decisions to use prudential borrowing require the approval of the City Mayor. The criteria below set normal expectations for investment decisions, but it is impossible to provide a framework for all potential opportunities: we do not know what might be available in the future. The City Mayor may approve investments which do not meet the criteria in this section 6 (the limits at section 5 will not be exceeded), but if he does so:-

(a) The reason will be reflected in the decision notice;
(b) The decision will be included in the next refresh of this strategy.

6.2 All proposals will be subject to a financial evaluation, signed by the Director of Finance. This will calculate expected return (see below), assess risk to the Council's capital invested, and ability to repay any prudential borrowing. The evaluation must therefore give evidence of a financially robust proposal, regardless of the other merits. The results of the evaluation will be reported in the decision report. For small purchases of property within the Corporate Estate Fund, a more streamlined evaluation can be prepared. Where the use of third-party contributions at the Council's risk is recommended, as an alternative to prudential borrowing, the assessment of this method of financing will be included in the evaluation.

6.3 Any investment for economic development purposes will accord with the Council's adopted strategies, except for early stage expenditure in contemplation of a new strategy.

6.4 The maximum prudential borrowing permitted for any given capital scheme will be £10 million. If the Council wanted to borrow more than £10 million on any particular scheme, it would be subject to a specific report to full Council.

6.5 Advances to third parties will require additional security where the total capital invested by the Council exceeds £2m, e.g. the underwriting of risk by a third party, or a charge on property with a readily ascertainable value and a number of potential purchasers.

6.6 The Council will look for a return on its capital invested, although this can be lower than a bank would seek (reflecting our cost of funds, and the expected service benefits). Except where a purchase is solely to improve the financial performance of the Corporate Estate, return will be measured by net present value (disregarding external contributions):-

(a) The usual yardstick for investment is that, on a prudent estimate of costs and income, investments must make a positive return when discounted at 3% per annum. A higher return may be sought where a project is riskier than normal;

(b) Where reasonably certain, growth in retained business rates can be included in the calculation of NPV until the date of the next national reset (although rates growth will continue to be accounted for as rates income, and not earmarked);

(c) Resultant savings in departmental budgets <u>cannot</u> be included in the calculation.

6.7 The City Mayor may take a conscious decision to accept lower returns for service or environmental reasons; (an alternative way of looking at this is to say that the Council will sometimes choose to accept modest returns instead of providing something at its own expense for service and/or environmental reasons). Such a decision will be transparent and recorded in the decision notice.

6.8 The following are deemed to be suitable investments:-

(a) Acquisition of commercial or industrial property;
(b) Construction or development of commercial or industrial property;
(c) Construction or development of non-HRA housing;
(d) Acquisition of land for development;
(e) Infrastructure provision at key development sites;
(f) Investments to support the Leicester and Leicestershire Enterprise Partnership;
(g) Loans to businesses to support economic development;
(h) Acquisition or construction of low carbon energy investments.

6.9 All investments and loans must be compliant with Government's subsidy control rules. Investments must also not be made primarily for an income return (though a decent income return is to be encouraged) but investments must also have another purpose such as promoting economic development.

6.10 <u>Acquisition of commercial or industrial property</u> can be considered where:-

(a) There is a tenant of sufficient quality; or strong evidence of market demand for the property (e.g. identified end use, or small tenanted units with a ready supply of prospective tenants); or the property generates other reasonably assured income; and

(b) There is the prospect of capital appreciation and a ready market for the Council's interest (or there will be a ready market at the end of the investment period); and

(c) There are either economic development or service reasons why the city would benefit from the council's ownership, or the acquisition improves the performance of the Corporate Estate. An example of economic development reasons might be to facilitate a significant business relocation to the city or surrounding area.

6.11 <u>Construction or development of commercial or industrial property</u> can be considered where the asset constructed or developed would generate a continuing income stream, and have a readily realisable capital value. Whilst a pre-let is regarded as highly desirable, a benefit of Council involvement is that strategically important development can be secured which would not attract normal commercial finance. New grade A office space is a key example. It is, however, essential that the Council can be confident of a return on its capital invested, and an NPV shall be calculated using prudent assumptions of any void periods.

6.12 <u>Acquisition of land for development</u> can be considered for strategic regenerative land assembly schemes, subject to the proviso that future development is planned and fundable:-

(a) The Council's return will usually arise from an appreciation in land values and this must be reasonably assured with a ready market;

(b) This type of investment is riskier than the acquisition of tenanted property, and a higher return would normally be sought.

6.13 The availability of other public funding to secure development will improve the acceptability of such proposals, as this will increase the return on the Council's capital invested.

6.14 <u>Infrastructure provision at key development sites</u> can be considered where development can be catalysed by provision of site infrastructure:-

(a) Investment can be considered where future disposals can be assumed with a reasonable degree of confidence; and

(b) Developments unlock strategic housing or commercial development on economic growth sites, or contribute towards bringing forward linked developments.

6.15 <u>Investments to support the LLEP</u> can take place to support economic development in the city or LLEP area. Such advances can be considered to support the LLEP's strategic plan, subject to confidence that money will be returned through business rate growth, other LLEP finance, or underwriting by the project owner.

6.16 Loans to businesses can be made at attractive rates (when compared to bank finance) for proposals which facilitate economic development, and where the Council can be confident that the money will be repaid. The following criteria will be applied:-

(a) Loans would normally be repayable within 10 years (or the Council has an asset which is readily realisable within that period, whether we choose to realise it or not);

(b) A minimum loan value of £100,000 will apply;

(c) Proposals must demonstrate that they are viable, i.e. there is a reasonable expectation that the capital and interest will be repaid;

(d) Security will usually be obtained (and always for higher value loans).

6.17 Low Carbon Energy Investments which help to reduce climate change can be considered. Any such investment will still be expected to make a positive return, though in making the investment the Council will consider the environmental and social benefits as well as the financial return.

7. **Monitoring of Investments**

7.1 Except where the City Mayor decides that an investment can be monitored in aggregate as part of the Corporate Estate, the following measures will be used to monitor performance of all investments. Performance will be reported annually:-

(a) Achieved return on capital invested;

(b) Capital appreciation;

(c) Timely receipt of returns;

(d) Jobs or other outputs created.

7.2 The monitoring and performance of the Corporate Estate will be reported separately as part of the Corporate Estate Annual Report. As a minimum, the report will include the following performance indicators:-

(a) Voids;

(b) Gross return;

(c) Net return;

(d) Capital appreciation.

7.3 The Corporate Estate will be monitored in its entirety. Measures for individual acquisitions are not set.

8. <u>Capacity, Skills and Culture</u>

8.1 The Council employs professional accountants who are skilled in carrying out investment appraisals, as well as regeneration, economic development and property specialists. Nonetheless, the more complex schemes will require external support to enable thorough due diligence to be undertaken and business cases to be developed and assessed. External specialists will work with Council clients to ensure they understand the public service dimension of the Council's business.

8.2 The Council will use whatever presentation techniques are appropriate when decisions on individual investments are sought; these will in particular focus on the risk assessment.

9. <u>Financial and Legal Implications</u>

9.1 The proposals are in accordance with the Council's statutory duties under the Local Government Act 2003, and statutory guidance.

10. <u>Background Papers</u>

10.1 CIPFA – Treasury Management in the Public Services, Code of Practice and cross sectoral guidance notes 2017 edition.

10.2 MHCLG – Statutory Guidance on Local Government Investments (3rd Edition) (2018).

10.3 HM Treasury – Public Works Loan Board future lending terms November 2020.

11 <u>Author</u>

Nick Booth – 0116 454 4063, nick.booth@leicester.gov.uk
Amy Oliver – 0116 454 5667, amy.oliver@leicester.gov.uk