Investment Strategy 2024/25

Decision to be taken by: Council

Date of Meeting: 21 February 2024

Lead director: Amy Oliver, Director of Finance

Useful information:

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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 or other assets (sometimes a considerable multiple of their net revenue budget). Additionally, the Government’s debt management office now forbids lending to authorities which have recently invested or intend to invest in schemes “primarily for yield.” This is regardless of the funding source for the investment and the stated reason for the authority seeking the lending. The Council does not invest primarily for yield and all schemes have a service or regeneration focus as the main reason for investment.

2.2 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 has included advances made to the Leicester and Leicestershire Enterprise Partnership (LLEP) for their purposes if the Council expected to make a return on the money. The LLEP is to be disbanded at the end of March 2024, following the Government’s decision that its functions should transfer to the City and County Councils as part of national reforms.

2.3 The Council has also invested 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.

2.4 The strategy excludes capital investment in social housing for both permanent and temporary accommodation, which is not done to achieve an investment return.

3. Recommendations

3.1 The Overview Select Committee is recommended to note the report and make any comments to the Director of Finance, prior to Council consideration.

3.2 Council is recommended to approve the Investment Strategy at Appendix A.

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 across the city 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.

Details are available in the Corporate Estate annual report. Much of the estate has been owned by the Council for decades and the income generated is a contribution to the General Fund.

It should be noted that guidance from DLUHC (Department of Levelling Up, Housing & Communities) and CIPFA (Chartered Institute of Public Finance and Accountancy) warns against investment activity which is disproportionately large in relation to an authority's finances. However, with net land and property investment income from the Corporate Estate accounting for less than 2% of the Council's net revenue budget in 2023/2024, this continues to represent a manageable risk in relation to the overall revenue budget.

(b) **Loans to local businesses and organisations**. A number of loans have been made. The repayments are on schedule:

i. 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. At the time of writing, £2.0m remains outstanding.

ii. A loan of £1.5m to Ethically Sourced Products Ltd (of which just under £1.1m remains outstanding). This loan carries a return equivalent to 4% per annum. It is expected that this loan will be fully paid off with a lump sum in December 2025.

iii. A loan of £450k in 2023 to Leicester Hockey Club (of which £422k has been drawn down to date), to improve sporting facilities at St Margaret's Pastures. The interest rate is 5% p.a.

iv. A loan of £1.5m to Leicester Community Sports Arena Ltd in 2023, to assist funding of expanded facilities at the Morningside Arena. The rate of interest is 5% p.a.

(c) **Regeneration schemes** with an element of Prudential Borrowing:

i. Expenditure of £5.4m was incurred to deliver 26,400 square feet of workspace at Dock 2 Pioneer Park, which was completed in March 2021. The scheme attracted £2.15m of external funding. Prudential borrowing was £1.7m. The medium-term impact on the Council's revenue is positive, with the combined Dock 1 and Dock 2 making a surplus of £213k in 2022/23.

ii. Work has begun on a £13.3m scheme to redevelop Pilot House to provide modern small scale office accommodation. This is partly funded by £8.6m Government grant and is expected to be completed in 2025.

iii. A major regeneration scheme of £24.7m (plus a £1.5m inflation contingency) including £19.4m of Government grant for Pioneer Park is underway. This incorporates schemes at Dock 3, Abbey Court and the Ian Marlow Centre, which will provide new facilities for small and medium businesses. Dock 3 is expected to be complete by April 2024, with Abbey Court and the Ian Marlow Centre following by October 2024. These schemes are expected to provide a significant net revenue surplus to the Council after borrowing costs.

4.2 The **LLEP** has managed the "Growing Places Fund" which has made loans to businesses and other organisations for economic development. The Fund was held by the City Council as the accountable body. This fund was originally financed with a capital grant from the Government and has been replenished as loans were repaid. The total amount presently available is c.£10m. It has not previously come within the remit of this investment strategy, as the Council has had no financial exposure. The LLEP is to be disbanded at the end of March 2024, following the Government's decision that its functions should transfer to the City and County Councils as part of national reforms. The Fund will come under their direct stewardship from April 2024. The City Council will manage the remaining two loans, with future repayments adding to the total funding available.

5. <u>**Investment Strategy**</u>

5.1 The Council's Investment Strategy can be found at Appendix A. The strategy outlines the priorities for investment and that schemes supported have a service or regeneration objective as the main reason for investing.

6. Financial, legal, equalities, climate emergency and other implications

6.1 Financial Implications

This report is regarding financial matters.

6.2 Legal Implications

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

Kevin Carter, Head of Law, Ext 37 4197

6.3 Equalities Implications

There are no direct equality implications arising from the report.

Surinder Singh, Equalities Officer, Ext 37 4148

6.4 Climate Emergency implications

Finance and investment can have significant climate-related impacts, depending on where funds are held and how they are used. As such, the council should consider opportunities to ensure that its investments are not contributing to negative climate and environmental impacts, as relevant and appropriate. In addition, opportunities for investments that provide positive benefits should also be considered, as noted within the section of this report on investments with environmental and socially responsible objectives.

Aidan Davis, Sustainability Officer, Ext 37 2284

6.5 Other implications (You will need to have considered other implications in preparing this report. Please indicate which ones apply?)

n/a.

7. Background information and other papers

7.1 HM Treasury – Public Works Loan Board future lending guidance, November 2023.
7.2 CIPFA – "Treasury Management in the Public Services, guidance notes for local authorities including police forces and fire and rescue authorities 2021 edition".

8. Summary of appendices:

Appendix A – Investment Strategy 2024/25

9. Is this a private report (If so, please indicate the reasons and state why it is not in the public interest to be dealt with publicly)?

No

10. Is this a “key decision”? If so, why?

APPENDIX A

INVESTMENT STRATEGY 2024/25

1. The Council will facilitate investment which benefits the people of Leicester and at the same time makes a return. All such investment is required to meet a service need or promote regeneration as the main objective, although making a financial return on investments would be a positive secondary objective.

2. The Government's debt management office forbids lending to authorities which have recently invested or intend to invest in schemes "primarily for yield." The Council does not invest primarily for yield and all schemes supported will have a service or regeneration main reason for investment.

3. The Council is prepared to take greater risks in the furtherance of this Investment Strategy than it would be with the Treasury Management Strategy. This is because investments here are principally for service purposes such as regeneration, not primarily to generate a financial yield.

4. The Council's financial 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). We have traditionally regarded this as less important because individual investments are small scale compared to the overall size of the Council. However, in future years with the expected depletion of cash balances, liquidity is expected to become more important to manage.

5. Property acquired under this investment strategy will be located:-

   (a) In the case of the Corporate Estate, within the boundary of the Leicester, Leicestershire, and Rutland area. (Usually, within the city).

   (b) If acquired for economic regeneration purposes, within or at the perimeter of the Leicester, Leicestershire, and Rutland area.

   (c) Potentially further afield to better meet wider service objectives, such as low-carbon assets. We have made no such investments in recent years.

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

   (a) Grants/contributions from third parties 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" has not in the past required genuine external borrowing as we have had 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, with revenue costs in future years. This category includes prudential borrowing in anticipation of future business rates growth in Enterprise Zones. It should be noted that recent significant increases in interest rates have made it much more difficult for new schemes to make a surplus unless significant Government grant is included within the financing.

7. 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."

8. 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	40
For other investments	40

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

10. Limits on total external debt are included in the Treasury Management Strategy.

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

12. Where the Council has an option of utilising third party contributions at the Council's risk, the Director of Finance will determine if this represents value for money as an alternative to prudential borrowing.

What we invest in and how we assess schemes

13. 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, unless previously approved by full Council. 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 within paragraphs 14 to 28 (the limits contained in paragraphs 8 and 9 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.

14. All proposals will be subject to a financial evaluation, and approval by the Director of Finance must be obtained. 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 set out in the decision report. For small purchases of property within the Corporate Estate, 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. All proposals for investment will explicitly describe what the main purpose the investment is being made, which cannot be primarily for yield.

15. 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.

16. The maximum prudential borrowing permitted for any given capital scheme by way of an Executive Decision will be £10m. Any proposals to borrow more than £10m on a particular scheme would be subject to specific approval by full Council.

17. Advances to third parties will normally 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.

18. 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).

(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 5% 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 Net Present Value (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 cannot be included in the calculation.

19. 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.

20. The following are deemed to be suitable investments, although not primarily for yield:-

(a) Acquisition of commercial or industrial property for regeneration.
(b) Construction or development of commercial or industrial property for regeneration.
(c) Construction or development of non-HRA housing (noting that any housing acquired for permanent or temporary social housing is outside the scope of the Investment Strategy).
(d) Acquisition of land for development.
(e) Infrastructure provision at key development sites.
(f) Loans to businesses to support economic development.
(g) Acquisition or construction of low carbon energy investments.

21. All investments and loans must be compliant with Government's subsidy control rules. Investments must not be made primarily for an income return (though a decent income return is to be encouraged) but must have an alternative primary purpose such as promoting economic development. The Council will also not try to rely on investment income which is disproportionate to the overall budget.

22. Acquisition of commercial or industrial property can be considered where there are either economic development or service reasons why the city would benefit from the Council's ownership. An example of economic development reasons might be to facilitate a significant business relocation to the city or surrounding area.

23. Construction or development of commercial or industrial property can be considered for regeneration purposes within Leicester, Leicestershire and Rutland area 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. It should be noted though that any such scheme needs to have a

main objective of regeneration (or service provision) and although financial gain is desirable it should not be the main driver of such investment.

24. Acquisition of land for development 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.

25. 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.

26. Infrastructure provision at key development sites 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 that unlock strategic housing or commercial development on economic growth sites or contribute towards bringing forward linked developments.

27. 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).

28. 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.

Monitoring of Investments

29. The performance of investments will be reported annually. Investments within the Corporate Estate will be monitored as part of the Corporate Estate Annual Report.

Capacity, Skills and Culture

30. 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.

31. 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.