

Investment Strategy Report 2020/21

Cheltenham Borough Council

Introduction

The Authority 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 other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy for 2020/21 meets 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. These activities lead to a cash surplus at various points of the year 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 £26.3m and £32.0m during the 2020/21 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 2020/21 for treasury management investments are covered in a separate document – the treasury management strategy - which is available via the Council's website.

Service Investments: Loans

Contribution: Subject to a business case, the Council will lend money to its subsidiaries. The Council also lends money to support local public services and stimulate local economic growth. These include loans to organisations and residents within the Borough which support the priorities of the Council.

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. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as below in table 1. Most of the loans made in the past have been to subsidiaries Cheltenham Borough Homes (CBH) and Gloucestershire Airport which is 50% shared with Gloucester City Council.

Table 1: Loans for service purposes in £

Category of borrower	31.3.2019 actual £			2020/21
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Charities	563,989	-	563,989	700,000
Cheltenham Borough Homes	6,520,875	-	6,520,875	107,000,000
Gloucestershire Airport	511,141	-	511,141	7,250,000

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The loans that the Council has made are limited to specific service areas and subsidiaries and the likelihood of non-payment is minimal. There is no history of non-payment and no evidence to suggest that there will be any default against the loans granted. As a result, no allowance for loss has been included against the loan balances. Should any indication be given that there is a risk of default then the risk will be assessed and a provision established at that time. Should a loan default, the Authority will make every reasonable effort to collect the full sum lent and recover any overdue repayments.

In addition to the loans granted the Council has included provision in its Treasury Management Strategy to loan up to £500,000 to both Ubico Limited and Cheltenham Borough Homes (CBH) and up to £100,000 to Publica Group (Support) Limited, Cheltenham Festivals, The Cheltenham Trust and Cheltenham BID should any company require our support. The Council is a shareholder in Gloucestershire Airport, Ubico and SWAP (South West Audit Partnership) and a shared owner in Publica. In these cases, the loan facility is to enable the Council to be able to provide a loan for short-term cash flow purposes.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding service loans by undertaking credit checks and ensuring that appropriate legal documentation is in place to secure the Council's money.

The Council also receives independent financial advice on its financial dealings from Arlingclose Limited.

Service Investments: Shares

Contribution: The Council has a £1 shareholding in Ubico Ltd. Ubico Ltd is wholly-owned by seven local authorities and operates as a not for profit enterprise. Ubico Ltd is an environmental services company which provides household and commercial refuse collection, recycling, street cleansing, grounds maintenance and fleet maintenance services to the Council. Also the Council has £435,222 shareholding in Gloucestershire Airport (at cost) which equates to 50%. The other 50% is retained by Gloucester City Council.

Security: One of the risks of investing in shares is that they could fall in value meaning that the initial outlay may not be recovered. The Council has no other shareholdings.

Table 2: Shares held for service purposes in £

Category of company	31.3.2019 actual £		
	Amounts invested at cost	Gains or losses	Value in accounts
UBICO	1	-	1
Gloucestershire Airport	435,222	1,264,778	1,700,000
TOTAL	435,223	1,264,778	1,700,001

Risk assessment: the Council has not invested into Ubico or Gloucestershire Airport to generate a financial return. The Council has invested purely to support service provision. Ubico is a cost sharing company – any surplus generated within Ubico is returned to the partner Councils [shareholders] similarly with any deficit met by the Councils. Through regular budget monitoring and sound financial management by Ubico and transparency within calculation of contract sums, the risk of any financial loss is mitigated.

Liquidity: the Council has not invested into Ubico or Gloucestershire Airport to generate a financial return. The Council has invested purely to support service provision. The Council has no intention to dispose of its investment in the foreseeable future.

Non-specified Investments: Shares are the only investment type that the Authority 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 Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Service Investments: Workshop Cheltenham

On 8th October 2019, Cabinet approved the recommendation to support the creation of the Workshop Development by Workshop Cheltenham Limited (WSC) on Chester Walk car park. WSC will provide a tier 2 growth hub, flexible workspace for creative industry start-ups and incubation units for cyber tech companies along with an events space and a new home for Cheltenham Festivals.

WSC approached the council to consider an investment into WSC to facilitate the delivery of the project. As a result, on 3rd March 2020, Cabinet approved (in exempt session) the proposal for an investment of up to £1.7m with WSC to facilitate the delivery of the facility.

The precise nature of the vehicle for delivery of the Workshop Development has yet to be determined and as such, Cabinet delegated responsibility to set up the most appropriate vehicle and investment mechanism to support WSC, including if necessary setting up a new company with WSC.

Due diligence is still required on the numbers set out in the proposal however the breakeven point for Workshop to be profitable is just below 50% occupancy if £1.7m is invested and 49.8% occupancy if £1.45m is invested. It is estimated that the occupancy will be an average of around 50% for the first year and then grow 5% per annum.

It is proposed that WSC will repay the investment on a straight line basis over the 10 year period, based on a value of up to £170k p.a. (1/10th of the investment sum). This will be the first draw on the gross profit and taken directly as a cost of running the venture along with costs such as the lease of the land to CBC. It is proposed that the council will receive a share of the net profit based on 60% to WSC and 40% to the council which ensures a commercial rate of return to the council. The full business case, including projected investment returns to the council, is contained within the exempt report and appendices approved by Cabinet on 3rd March 2020.

As such, the following table includes parameters to allow for an investment of up to £1.7m to support the development of Workshop Cheltenham.

Table 1: investment for service purposes in £

Category of borrower	31.3.2019 actual £			2020/21
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Workshop Cheltenham Limited	-	-	-	1,700,000

Commercial Investments: Property

Investment Property is defined in the CIPFA code of practice on Local Authority Accounting as property (land or buildings, or both) held solely to earn rentals or for capital appreciation, or both. The Council holds a number of assets which it classifies as Investment Properties.

Contribution: The Council owns a number of Investment Properties within Cheltenham, with the intention of generating a revenue income to support the revenue budget.

Table 4: Property held for investment purposes in £ (including HRA Investment properties)

Property	Purchase Price	01.4.18	31.3.2019 actual £		31.3.2020
		Value in accounts £	Purchases, Gains or (losses)	Value in accounts £	Expected value* £
Investment Property within Cheltenham	Various	35,320,000	40,673,000	75,993,000	104,097,200

**During 2019/20 the council purchased land to develop, costing £39.6m, of which £28.1m (the General Fund proportion) is classified as Investment property, the value of which at 31st March 2020 is currently being assessed for the year end accounts.*

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 cost including taxes and transaction costs.

A fair value assessment of the Authority's investment property portfolio is made each year as part of the final accounts process. Investment Property is valued at market value.

The fair value of the Authority's investment property portfolio is included in the Statement of Accounts, based upon 'market value'. The Council's Investment Property is held primarily to generate a stable income stream to support the revenue budget. Should a property be sold any profit/loss on disposal will be recognised at that point. The Council has no plans to dispose of any Investment Property in the near future.

Risk assessment: The Council aims to generate a revenue return from its Investment Property assets which is greater than the return generated by its Treasury Management activity. It is understood that the fair value of property will fluctuate, although it is anticipated that the revenue returns in 2020/21 will remain constant. The Authority assesses the risk of movement in asset values before entering into and whilst holding property investments and mitigates the risk by purchasing property with secure tenants on long leases.

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. To ensure that the Council has cash funds that can be accessed when they are needed, the Treasury management policy includes the provision of liquid investments should the Council be in need of cash. It is not anticipated that the Council would need to sell any Investment Property at short notice.

Loan Commitments and Financial Guarantees

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

The Authority is a shareholder of Ubico Ltd and Gloucestershire Airport Ltd, and owner by guarantee and is a joint partner in Publica Group (Support) Limited (¼ owner). In both cases, should the company overspend the Council would be liable for its share of the additional costs. In both companies, sound financial management and budgetary control mitigate the risk that additional sums will be required without adequate notice.

Proportionality

The Authority is dependent on investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the General Fund expenditure planned to meet the service delivery objectives of the Authority is dependent on achieving the expected income from treasury investments over the lifecycle of the Medium Term Financial Plan. Should it fail

to achieve the expected income targets, the Authority will be required to draw additional balances from reserves, or generate savings elsewhere within the budget to continue to provide its services.

Table 4: Proportionality of Investments in £

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Forecast	2022/23 Forecast
Gross service expenditure*	35,498,605	35,720,115	34,904,403	35,602,491	36,314,541
Investment income	3,125,720	4,996,209	4,851,409	4,851,409	4,851,409
Proportion	8.8%	13.99%	13.9%	13.6%	13.4%

* Excluding Housing Benefit payments.

Borrowing in Advance of Need

Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority has plans to borrow in 2020/21 to invest in new capital schemes. Any funds borrowed will be in relation to specific schemes and based upon the cash required for the chosen schemes. There are no plans to borrow in advance of need.

Capacity, Skills and Culture

Summary of knowledge and skills available to the authority:

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director Finance and Assets is a qualified accountant of fellowship status with 20 years' experience. The Managing Director Place and Growth has over 30 years' experience in regeneration and development industry, and has worked in both the private and public sectors, in a delivery and advisory capacity. The Head of Property Services and Asset Management has over 25 years' experience in the public/private retail estate market. The Council pays and actively encourages staff to study towards relevant professional qualifications.

Where Council employed staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. The Council employs other specialist advisers to advise upon specific, extra-ordinary transactions as required. Examples of such transactions include property acquisitions, and loans to third parties. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

The Council has experience of investing in commercial property in recent years. The Council's property service's officers have the following qualifications or status:

- BSc Hons Real Estate Management
- Member Royal Institute Chartered Surveyors

- Royal Institute Chartered Surveyors Registered Valuer
- Member Chartered Institute of Public Finance and Accountancy

The Council's legal team, provided by One Legal, have experience of carrying out legal due diligence checks, particularly for commercial property acquisitions, and the legal officers have the following qualifications or status:

- Chartered Legal Executive
- Solicitor
- Para-Legals

The Property and Legal teams work together with the Finance team to support the Council's Executive Director Finance and Assets in developing investment proposals for the Council. External specialist advice is obtained when required to support these teams.

The Council has previously invested in a range of diversified commercial properties which are delivering a sustainable revenue stream to the Council. Any further investment in non-treasury management transactions will be set out in this, or future iterations of this strategy.

Scrutiny Arrangements:

The Cabinet will make decisions or make recommendations to full Council on new investments that are not part of Treasury Management Activity.

Financial Performance is reported quarterly to Cabinet. This will include the financial performance of the Treasury management function and any other revenue generating investments.

Treasury Management performance is reported at half-year and year-end to the Treasury Management Panel and to full Council.

The Council's internal audit provider (South West Audit Partnership Ltd) regularly audits the Council's treasury management activity and its processes and procedures for approving investment and performance management. SWAP report to the Council's Audit Committee.

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. This includes amounts the Authority is contractually committed to and any guarantees the Authority has issued over third party loans.

Table 5: Total investment exposure in £

Total investment exposure	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Forecast
Treasury management investments	19,493,550	19,000,000	19,000,000
Service investments: Loans	7,834,503	7,434,135	7,170,599
Service investments: Shares (at cost)	435,224	435,224	435,224
Commercial investments: Property	75,993,000	104,087,400	115,817,820
TOTAL INVESTMENTS	103,756,277	130,956,759	142,423,643
Commitments to lend ¹	-	-	-
TOTAL EXPOSURE	103,756,277	130,956,759	142,423,643

¹ This excludes the potential loan facility offered to Ubico Limited, Publica Group (Support) Limited and Cheltenham Trust for cash flow purposes.

How investments are funded: Government guidance is that these indicators should include how investments are funded. The Council's plans for borrowing are limited to a small number of schemes – which are primarily for service delivery – which do not form part of this report. As a result, investments funded by borrowing can be presented as follows:

Table 6: Investments funded by borrowing in £

Investments funded by borrowing	31.03.2019 Actual	31.03.2020 Forecast	31.03.2021 Forecast
Treasury management investments	-	-	-
Service investments: Loans	7,834,503	7,434,135	7,170,599
Service investments: Shares	-	-	-
Commercial investments: Property	52,553,048	79,527,259	90,102,936
TOTAL FUNDED BY BORROWING	60,387,551	86,961,394	97,273,535

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 7: Investment rate of return (net of all costs)

Investments net rate of return	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	1.85%	2.00%	2.00%
Service investments: Loans			
Cheltenham Borough Homes	3.93%	3.93%	3.93%
Gloucestershire Airport	1.80%	1.80%	1.80%
Everyman Theatre	3.93%	3.93%	3.93%
St Margarets Hall	3%	3%	3%
Service investments: Shares	0%	0%	0%
Commercial investments: Property yield/contribution (net of borrowing)	£1,747,275	£3,194,651	£3,390,745
Commercial investments: Property	5.24%	4.19%	4.44%

Net Yield: This indicator calculates the annual profit (income minus costs) generated by an asset, divided by its price. The costs that you would normally consider include agent fees, insurance, an allowance for repairs, an allowance for voids (the property being empty), service charge and ground rent. In order to provide consistency across the property portfolio, net yield is used to assess the returns.

Table 8: Net yield on commercial property investments

Net Yield	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Commercial investments: Property	5.86%	5.25%	5.25%