Isle of Wight Council Investment Strategy (Non-Treasury Investments) 2024-25

Isle of Wight Council

Document Information

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1.0	05 February 2024	First draft – template review, 24-25 budget implications and external advisor recommendations

Contents

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 This investment strategy meets the requirements of statutory guidance on local authority investments issued by the government in January 2018 and focuses on the second and third of these categories.

1.3 The statutory guidance defines investments as “all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios.” The council interprets this to exclude:

a) trade receivables which meet the accounting definition of financial assets but are not investments in the everyday sense of the word and;
b) property held partially to generate a profit but primarily for the provision of local public services. This aligns the council’s definition of an investment with that in the 2021 edition of the CIPFA Prudential Code, a more recent piece of statutory guidance.

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. 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 average £18.4 million during the 2024/25 financial year.

2.2 **Contribution**: The contribution that these investments make to the council’s objectives is to support effective treasury management activities.

2.3 **Further details**: Full details of the council's policies and its plan for 2024/25 for treasury management investments are covered in a separate document, the treasury management strategy.

3 Service Investments: Loans

3.1 **Contribution**: The council lends money to local businesses to support local public services and stimulate local economic growth, and in the past small loans have been made to local residents. These include loans for, but are not limited to, a sustainable energy generation scheme, the promotion and development of housing affordability, the promotion of tourism, and the development of local employment and regeneration.

3.2 **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 council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes

Category of Borrower	31.03.2023 actual			31.03.24	2024/25
	Balance Owing £m	Loss Allowance £m	Net Figure in Accounts £m	Forecast Net Figure £m	Approved Limit £m
Subsidiaries	-	-	-	-	25.0
Local Businesses	1.3	-	1.3	1.4	10.0
TOTAL	**1.3**	**-**	**1.3**	**1.4**	**35.0**

3.3 Accounting standards require the council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the council's statement of accounts are 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.

3.4 **Risk assessment:** The council assesses the risk of loss before entering into and also whilst holding service loans. This is done by ensuring that all loan applications are subject to a business case review to assess how it contributes to the council's corporate plan objectives. It is then presented to Cabinet for their approval. Whilst the council does not have any explicit credit criteria, once this approval of the business case has been obtained, proper due diligence is undertaken, using third party external advisors if there is insufficient staff knowledge and skills. That due diligence will include an evaluation of the company's financial standing using standard ratio analysis as well as an in-depth analysis of future financial forecasts using principles such as Debt Service Cover Ratios and other techniques such as sensitivity analyses. Finally, following the completion of the due diligence the Director of Finance and Section 151 Officer will confirm whether the loan will proceed.

4 Service Investments: Shares

4.1 **Contribution**: The council invests in the shares of local organisations that meet the council's strategic objectives, especially in the areas of sustainable energy and social housing.

4.2 **Security**: One of the risks of investing in shares is that they 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.

Category of Company	31.03.2023 actual			31.03.2024	2024/25
	Balance Owing £m	Loss Allowance £m	Net Figure in Accounts £m	Forecast Net Figure £m	Approved Limit £m
Subsidiaries	-	-	-	-	10.0
Suppliers	-	-	-	-	2.0
Local businesses	-	-	-	-	2.0
TOTAL	**-**	**-**	**-**	**-**	**14.0**

4.3 **Risk assessment**: The council assesses the risk of loss before entering into and whilst holding shares by applying the following procedure. All investments in shares are subject to a business case which assesses how it contributes to the council's corporate plan objectives and then it is presented to Cabinet for their approval. Whilst the council does not have any explicit credit criteria, once this approval to the business case has been obtained, proper due diligence is undertaken, using third party external advisors if there is insufficient staff knowledge and skills. That due diligence will include an evaluation of the company's financial standing using standard ratio analysis as well as an in-depth analysis of future financial forecasts using principles such as debt service cover ratios and other techniques such as sensitivity analyses. Finally, following the completion of the due diligence the Director of Finance and Section 151 Officer will confirm whether the investment will proceed.

4.4 **Liquidity:** Any investment in shares would be undertaken for the purpose of regeneration, the provision of additional employment or affordable housing which are all for long term investment and are not subject to liquidity considerations.

4.5 **Specified investments:** The Council defines these as being sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the Council has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. These include investments with:

- The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational bonds of less than one year's duration.
- A local authority, parish council or community council.
- An investment scheme that has been awarded a high credit rating by a credit rating agency (this covers a money market fund rated by Standard and Poor's, Moody's or Fitch rating agencies).
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

4.6 **Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as a non-specified investment. The council does not intend to make any investments denominated in foreign currencies.

4.7 Shares or investments with high credit quality, as defined by specified investments above, are the only non-specified investment type that has been identified by the council that it is proposed to undertake. 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.

FOR PUBLICATION – CORPORATE POLICY

5 Commercial Investments: Property

5.1 **Contribution:** The Council invests in UK commercial property with the intention of making a return that will be spent on local public services.

Table 3: Property held for investment purposes.

Property	Actual Purchase Cost £m	31.03.2023 Actual Brought forward	31.03.2023 Actual Gains or (Losses) £m	31.03.2023 Actual Value in Accounts £m	31.03.2024 Expected Gains or (Losses) £m	31.03.2024 Expected Value in Accounts £m
Salford	11.4	13.7	(1.4)	**12.3**	-	**12.3**
Aylesford	9.2	10.7	(1.7)	**9.0**	-	**9.0**
Oxford	10.6	12.2	(2.7)	**9.5**	-	**9.5**
Southampton	3.9	4.9	(0.9)	**4.0**	-	**4.0**
TOTAL	**35.1**	**41.5**	**(6.7)**	**34.8**	**-**	**34.8**

The properties were all acquired during the year 2018-19. These assets are required to be valued annually in accordance with CIPFA Code of Practice, with the next valuation in March 2024. Although the value of investments can potentially change, there is no indication currently that the value is expected to change.

5.2 **Security:** 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.

5.3 A fair value assessment of the council's investment property portfolio has been made in the past twelve months, and the underlying assets provide security for capital investment. Should the 2023-24 year-end accounts preparation and audit process value these properties significantly below their purchase cost, then an updated investment strategy will be presented to full council, with the annual report on the performance of the commercial property investment portfolio detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

5.4 **Risk assessment:** The council assesses the risk of loss before entering into, and whilst holding, property investments by applying the principles laid out in TMP13 Non-Treasury Investment Practices. These include the assessment of the financial strength of any tenants and good portfolio management in order to mitigate the risks.

5.5 **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 invested funds can be accessed when they are needed, for example to repay capital borrowed, the council has produced a commercial investment strategy which can be found here which details the procedures to mitigate this risk.

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.

6.2 The council has not held any loan commitments or financial guarantees since April 2019 and has no plans to undertake any new commitments or guarantees in the period of this strategy.

7 Proportionality

7.1 The council plans that profit generating investment activity will assist in achieving a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium-Term Financial Strategy.

Table 4: Proportionality of Investments

	2022/23 Actual £m	2023/24 Forecast £m	2024/25 Budget £m	2025/26 Budget £m	2026/27 Budget £m
Net service expenditure	158.1	179.0	195.1	204.8	210.8
Gross investment income	1.8	1.9	2.0	2.1	2.1
Proportion	**1.14%**	**1.06%**	**1.03%**	**1.03%**	**1.00%**

7.2 Should the council fail to achieve the expected net profit, the council has contingency plans for continuing to provide these services as described below, recognising however at these low proportions any service impact is likely to be small:

- In general, the council undertakes a review of all financial risks facing the council on an annual basis, and based on this assessment the overall level of Corporate Contingency and the General Reserves are planned. This enables the council to be able to continue services as planned in the short-term whilst any other remedial or mitigating actions are implemented e.g. such as increasing the council's savings requirements in future years.

- The council maintains a specific earmarked reserve which is being built over time to a level sufficient to provide a safeguard against any difference in the fair value of the assets versus acquisition cost, any potential loss of rental income and future improvement works to properties.

8 Borrowing in Advance of Need

8.1 The Government guidance is that council's must not borrow more than, or in advance of, their needs purely to profit from the investment of the extra sums borrowed.

8.2 The council had previously approved the purchase of commercial investments within a portfolio of up to £100 million, but since the issue of the updated Government guidance the council does not intend to increase the size of its commercial property investment portfolio beyond the current holdings detailed above.

8.3 An earmarked reserve will exist to guard against any reduction in the fair value of the property assets and to cover the costs of rental voids.

8.4 The council maintains general reserves and contingencies at levels that have been based on all known and expected financial risks and their likelihood of occurrence.

9 Capacity, Skills and Culture

9.1 **Elected members and statutory officers:** The Full Council agreed to the establishment of a commercial property fund in September 2017. The authorisation of expenditure from this fund was delegated by the council to the Chief Executive, the Director of Finance and Section 151 Officer and the Cabinet Member for Housing and Finance. Any decisions will only be made once the due diligence has been carried out and reviewed.

9.2 All investments considered for purchase will have to undergo both qualitative and quantitative appraisal in order to determine whether they are suitable to be included into the portfolio. The portfolio was created through an agreement with Portsmouth City Council to provide the services of their property investment team. This team has private sector fund investment experience and has a network of specialists that are able to provide advice as and when required.

9.3 All property acquisitions required a business case which included a full financial appraisal. The detailed business case and financial appraisal included building surveys, environmental surveys and valuations in accordance with the Red Book. In addition, properties continue to be revalued on an annual basis.

9.4 There are no further planned commercial property acquisitions and the fund has now settled into a management phase for which responsibility has transferred from a contractual arrangement with Portsmouth City Council to the Isle of Wight Council's in-house Property Services department who have the necessary knowledge and training.

9.5 **Corporate governance:** The council has established a set of Practices (TMP13 Non-Treasury Investment practices) that detail out how the investment in other financial assets and property is to be undertaken.

9.6 On an annual basis the Full Council will receive a Capital Strategy as well as this Investment Strategy, which will detail all the non-treasury investments.

9.7 On an annual basis the Audit & Governance Committee receives a report from the property services team in which they provide details of the current investment property portfolio including the current performance as well as looking at the medium to long-term strategy.

9.8 Service investments are not provided with financial performance targets directly. These will contribute towards council objectives such as the provision of affordable housing and additional employment. There will be an inherent benefit in that these will alleviate pressures on other council services such as homelessness which can contribute towards savings targets.

10 Investment Indicators

10.1 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.

10.2 **Total risk exposure**: 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

Total investment exposure	31.03.2023 Actual £m	31.03.2024 Forecast £m	31.03.2025 Forecast £m
Treasury management investments	27.0	12.8	10.1
Service investments: Loans*	1.3	1.4	35.0
Service investments: Shares**	-	-	14.0
Commercial investments: Property	34.8	34.8	34.8
TOTAL INVESTMENTS	**63.1**	**49.0**	**93.9**
Commitments to lend	-	-	-
Guarantee issued on loans	-	-	-
TOTAL EXPOSURE	**63.1**	**49.0**	**93.9**

* As per Table 1 above
** As per Table 2 above

10.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing.

Investments funded by borrowing	31.03.2023 Actual £m	31.03.2024 Forecast £m	31.03.2025 Forecast £m
Service investments: Loans	1.3	1.4	35.0
Service investments: Shares	-	-	14.0
Commercial investments: Property	34.8	34.8	34.8
TOTAL FUNDED BY BORROWING	**36.1**	**36.2**	**83.8**

10.4 **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	2022/23 Actual	2023/24 Forecast	2024/25 Forecast
Treasury management investments	1.69%	5.33%	5.43%
Service investments: Loans	2.63%	4.65%	4.66%
Commercial investments: Property	2.81%	2.91%	3.42%
TOTAL INVESTMENTS	**3.24%**	**5.41%**	**5.82%**

10.5 **Other investment Indicators**: Other indicators that explain the extent to which the Council is exposed to the cost of servicing the debt associated with its investments and the value of debt compared to the value of property assets are described below:

Debt to Net Service Expenditure
An indicator of the financial strength and ability of the Council to repay its debts. This ratio is falling over time, as the council plans to repay some of its current outstanding debt using existing short term invested cash.

Commercial Income to Net Service Expenditure Ratio:
Represents the reliance by the Council on commercial income to fund services.

Interest Cover Ratio:
Indicates the extent to which the net income from investment properties will cover the debt that financed the properties.

Loan to Value Ratio:
Indicates whether the market value of the properties is likely to be sufficient to repay the debt that financed them.

Table 8: Other investment indicators

Indicator	2022/23 Actual	2023/24 Forecast	2024/25 Forecast
Debt to net service expenditure	125.4%	101.9%	88.2%
Commercial income to net service expenditure ratio	1.12%	1.05%	1.05%
Interest cover ratio	233.8%	238.8%	277.2%
Loan to value ratio	100.0%	100.0%	100.0%