Isle of Wight Council

INVESTMENT STRATEGY

2021-22

Document Information

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1.2	5 February 2021	For Review by CW/KH
1.3	9 February 2021	Correction re Borrowing in Advance of Need
1.4	15 February 2021	Post CW & KH Review

Contents

1 Introduction

1.1 The council invests its money for three broad purposes:

1.1.1. 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),

1.1.2. to support local public services by lending to or buying shares in other organisations (service investments), and

1.1.3. 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 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. 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 £13.0 million during the 2021/22 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 2021/22 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	31.03.2020 actual			31.03.21	2021/22
	Balance owing £m	**Loss allowance £m**	**Net figure in accounts £m**	**Forecast Net Figure £m**	**Approved limit £m**
Subsidiaries	-	-	-	-	20.0
Local Businesses	3.0	-	3.0	1.4	10.0
TOTAL	**3.0**	**-**	**3.0**	**1.4**	**30.0**

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 whilst holding service loans by ensuring that all loan applications are subject to a business case review 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 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	31.03.2020 actual			2021/22
	Balance owing £m	loss allowance £m	Net figure in accounts £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.

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	31.03.2020 actual		31.03.2021 expected	
	Purchase cost £m	**Gains or (losses) £m**	**Value in accounts £m**	**Gains or (losses) £m**	**Value in accounts £m**
Salford	11.4	-	**11.0**	-	**11.0**
Aylesford	9.2	-	**8.6**	-	**8.6**
Oxford	10.6	-	**10.0**	-	**10.0**
Southampton	3.9	-	**3.5**	-	**3.5**
TOTAL	**35.1**	**-**	**33.1**	**-**	**33.1**

The properties were all acquired during the year 2018-19. The acquisition of commercial properties required substantial transaction costs of £2.1 million, including legal and stamp duty fees, which under proper accounting practices are allowed to be capitalised. These costs have not increased the market value of these properties so had resulted in a valuation loss during financial year 2018/19, which is normal. These assets are required to be valued annually in accordance with CIPFA Code of Practice, with the next valuation in March 2021; there is no evidence to suggest the value is likely 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 2020-21 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 through 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

	2019/20 Actual £m	2020/21 Forecast £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
Net Service expenditure	152.5	187.0	151.6	160.6	162.9
Gross Investment income	1.6	1.7	1.7	1.7	1.7
Proportion	**1.05%**	**0.91%**	**1.12%**	**1.06%**	**1.04%**

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 plans its overall level of Corporate Contingency and General Reserves accordingly; 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

In March 2020 the Government launched a consultation on revised Public Works Loan Board (PWLB) lending terms and guidance. The consultation closed in July 2020 and has resulted in new lending terms.

The key features of the new lending terms are:

- As a condition of accessing the PWLB, Local Authorities (LAs) will be asked to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. In order to minimise the administrative burden for LAs, this process is closely modelled on the existing application process that most large local authorities follow to access the Certainty Rate (a 20bps discounted rate offered by the PWLB).

- As part of this, the PWLB will ask the Section 151 Officer of the local authority to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This assessment is based on the Section 151 Officer's professional interpretation of guidance issued alongside these lending terms.

- It is impossible to reliably link particular loans to specific spending, so this restriction applies on a 'whole plan' basis – meaning that the PWLB will not lend to any local authority which plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB.

- When applying for a new loan, the local authority will be required to confirm that the plans they have submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield is still accurate.

- The government is committed to the prudential system and has no intention of routinely reviewing the purpose of individual loans. If HM Treasury has concerns that a loan may be used in a way that is incompatible with HM Treasury's duties to ensure that public spending represents good value for money to the taxpayer, the department will contact the local authority to gain a fuller understanding of the situation. Should it transpire that a local authority has deliberately misused the PWLB, HM Treasury has the option to suspend that LA's access to the PWLB, and in the most extreme cases, to require that loans be repaid. In practice such an eventuality is highly unlikely and would only occur after extensive discussion with the local authority in question.

The council had previously approved and borrowed funds for its existing investments to enable the purchases of commercial investments within a £100 million portfolio.

The changes in the PWLB lending terms has now curtailed all acquisition activity and therefore the council does not intend to increase the size of its commercial property investment portfolio beyond £33 million.

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.

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 has agreed the establishment of a commercial property fund. The authorisation of expenditure from this fund has been delegated by the council to the Chief Executive, the Section 151 Officer and the Cabinet member for Resources and these 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 council has entered into 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 require a business case and full financial appraisal. The detailed business case and financial appraisal includes building surveys, environmental surveys and valuations in accordance with the Red Book. In addition, properties are revalued on an annual basis.

9.4 The Commercial Property Portfolio is managed by the property investment team from Portsmouth City Council, who are qualified members of Royal Institute of Chartered Surveyors.

9.5 **Commercial deals:** The property investment team has experience of acquiring commercial property for local authorities, and it is part of their contractual arrangements that their staff have the necessary knowledge and training.

9.6 **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.

9.7 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.

9.8 Every six months the Audit Committee receives a report from the property investment team at Portsmouth City Council 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.

9.9 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	**31.03.2020 Actual £m**	**31.03.2021 Forecast £m**	**31.03.2022 Forecast £m**
Treasury management investments	67.0	64.4	15.9
Service investments: Loans	3.0	3.0	10.0
Service investments: Shares	-	-	14.0
Commercial investments: Property	33.1	33.1	33.1
TOTAL INVESTMENTS	**103.1**	**100.5**	**73.0**
Commitments to lend	-	-	-
Guatantee issued on loans	-	-	-
TOTAL EXPOSURE	**103.1**	**100.5**	**73.0**

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	**31.03.2020 Actual £m**	**31.03.2021 Forecast £m**	**31.03.2022 Forecast £m**
Service investments: Loans	3.0	1.4	10.0
Service investments: Shares	-	-	14.0
Commercial investments: Property	35.1	35.1	35.1

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	2019/20 Actual	2020/21 Forecast	2021/22 Forecast
Treasury management investments	0.85%	0.09%	0.09%
Service investments: Loans	0.86%	1.19%	1.19%
Commercial investments: Property	1.82%	1.97%	1.97%
TOTAL INVESTMENTS	**1.03%**	**0.91%**	**1.31%**

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	2019/20 Actual	2020/21 Forecast	2021/22 Forecast
Debt to net service expenditure	183.2%	139.5%	151.6%
Commercial income to net service expenditure ratio	0.39%	0.37%	0.46%
Interest cover ratio	200.0%	230.0%	230.0%
Loan to value ratio	106.0%	106.0%	106.0%