

TRAFFORD COUNCIL

Report to: Executive 24 July 2017
Council 26 July 2017
Report for: Decision
Joint Report of: Executive Member for Investment, Executive Member for Corporate Resources and the Chief Finance Officer

Capital Investment Fund

Summary

At Budget Council on 22 February 2017 a fund of £20m was established to support the acquisition of assets that will support local regeneration and/or yield future sustainable revenue streams for the Council and also cover borrowing costs. This report seeks approval to increase this fund in line with the Investment Strategy detailed in the Part B confidential appendices to this report. The Investment Strategy is designed to move the Council into a more sustainable budget position. This would enable the Council to fund projects which will deliver significant economic development and regeneration benefits for the area and/or increase the Council's income generating capacity which would support and maintain the provision of services in future years.

The Council is required to set prudential indicators in accordance with the CIPFA Prudential Code which are designed to support and record decisions taken on affordability, sustainability and professional good practice and these are outlined within the Part B section to this report.

Recommendations

That the Executive recommends that Council:-

1. approves and adopts the Summary Investment Strategy as detailed in the Part B appendices
2. approves the increase to the Capital Investment Programme in 2017/18 as detailed in the associated Part B appendices
3. approves the governance structure and reporting and monitoring arrangements proposed for an Investment Management Board (IMB) as detailed in Paragraphs 15
4. approves the setting up of an Investment Management Company to manage investments where appropriate and delegates authority to the Director of Legal and Democratic Services in consultation with the Chief Executive and the Executive Member for Investment to take all necessary steps to establish a company with the powers to invest and manage investments in line with the

Summary Investment Strategy;

5. delegates decision making in accordance with the provisions of the Summary Investment Strategy to the IMB
6. approves the amendment to the MRP policy as outlined in Paragraph 19
7. approves the changes to the Prudential Borrowing indicators as set out in the appendices in the Part B report.
8. approves the changes to the Treasury Management investment counterparty limits as detailed in Part B appendices to this report.

Contact person for access to background papers and further information:

Name: Graeme Bentley

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Background Papers: None

Implications:

Relationship to Policy Framework/Corporate Priorities	Low Council Tax and Value For Money / Economic Growth and Development
Financial	The Capital Investment Fund budget included in the Capital Programme will increase in line with the Investment Strategy and included in the Part B section to this report. Proposals to utilise the fund will be subject to the appropriate level of due diligence and be capable of providing a sustainable revenue stream to the Council and to cover any related borrowing costs.
Legal Implications	As detailed in the report
Equality/Diversity Implications	None as a result of this report
Resource Implications e.g. Staffing / ICT / Assets	None as a result of this report
Risk Management Implications	The appointment of CBRE as investment advisors will enable an objective assessment of the risk levels within each investment and over the portfolio as a whole. The approach to risk is set out in more detail in the investment strategy.
Health & Wellbeing Implications	None as a result of this report
Health and Safety Implications	Not Applicable

BACKGROUND

1. Two reports have previously been presented to Executive in December 2016 and February 2017 setting out a proposed approach to securing and developing investment opportunities which will generate sustainable income streams to support

the Council's revenue budget. A sum of £20m was approved by Council in February 2017 as part of the the Capital Programme to support this approach.

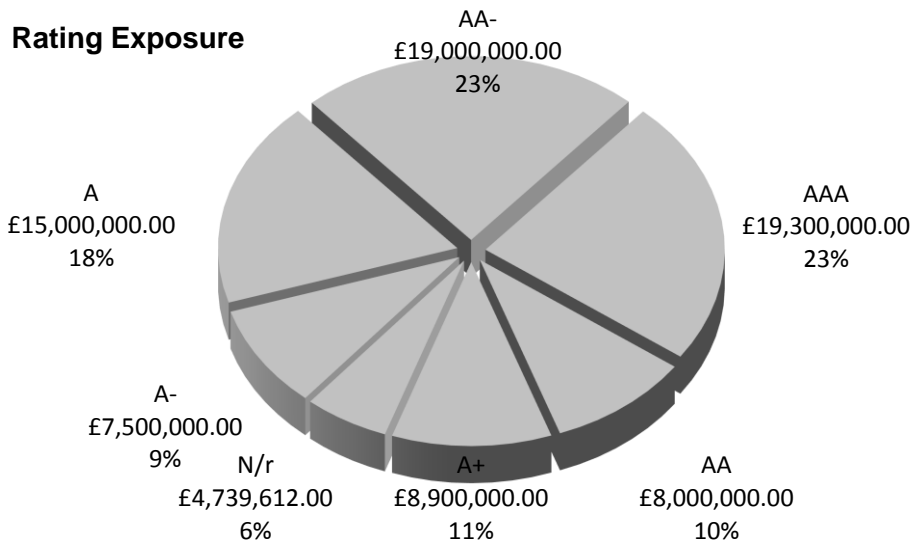
2. Since those reports a great deal of work has been undertaken to further refine our approach to investment and earlier this month CBRE were appointed as investment advisors to support the Council in developing its investment strategy and to manage its future investments.
3. It has also become apparent that given the range and scale of the programmes the Council is considering investing in to promote the economic development and regeneration of the area and the size of the financial challenge the Council will face to balance the budget in future years and avoid having to make significant cuts to essential services, together with the need to ensure we have a balanced portfolio of investment assets, that the size of the overall investment fund should be increased substantially.
4. Going forward the Investment Strategy will only be one element of the Council's budget strategy and service savings and efficiencies will continue to be sought in future years, albeit that it is expected that the reliance on generating sustainable, low risk revenue streams will play an increasing role given the extent of savings already delivered since 2010/11.

EXISTING INVESTMENTS

5. The Council undertakes investments on a daily basis as part of the Treasury Management function which operates within an investment strategy and already owns a portfolio of investment assets. The table below details the value of all these investments as at 31 March 2017:-

Investment type	Value £m	2016/17 Return £m	2016/17 Return %
Treasury Management Cash Investments	77.7	0.7	0.67
Treasury Management Property Investments (See Para 7)	4.7	0.2	4.61
Investment Property	34.4	2.1	6.1
Total	116.8	3.0	2.6

6. The Treasury Management activity involves investing temporarily surplus balances arising from monies received in advance of spend and other balances and reserves. This generates income in the form of investment interest. A breakdown of the Council's investments at 31 March 2017 is shown below:-



7. Whilst the majority of funds are invested through the money markets the Council does hold a long term treasury investment of £5m with the Church Commissioners Local Authority Property fund; a fund which is only available to public sector organisations. The objective of the fund is to generate long-term capital growth whilst generating returns in the form of annual dividends by investing in commercial property throughout the UK. A major advantage of the Fund is that, unlike other property investments, it does not need to be accounted for in the capital programme.
8. The Council also owns an existing property portfolio valued at £34.4m including an investment in airport land together with a number of leasehold interests in the town centres such as Stretford Mall and Stretford Arndale. In addition to this the Council also receives income through its shareholding in the airport and over the past few years this has generated between £2.5m and £3.5m per annum in shareholder dividends.
9. It is important that any future investment strategy considers the potential to maximise returns from the current investments.

INVESTMENT STRATEGY DEVELOPMENT

10. It is crucial that in developing an investment strategy appropriate guidance is followed. DCLG Guidance on Local Government Investments considers three key areas. The Strategy:-
 - should set out the authority's policies for prudent management of its investments and for giving priority firstly to security of investments and secondly liquidity followed by yield.
 - Should identify the procedures for monitoring, assessing and mitigating risk of loss of the invested sums
 - should be approved by full Council.
11. A copy of the Summary Investment Strategy can be found in the Part B annex to this report.

12. A full version of the Investment Strategy will be brought back to the Executive and Council at the September meetings

GOVERNANCE

13. CBRE have been appointed as the Council's investment advisors and will assist the Council with developing the Investment Strategy and will also identify investment opportunities aligned with the objectives and strategy and make recommendations for investments and may assist in due diligence on any purchases.
14. It is crucial that the Council is able to act quickly in order to secure investments and therefore will need to procure a technical team capable of supporting the completion process including legal, building surveyors and environmental consultants.
15. As part of the decision making process it is recommended that an Investment Management Board is established to oversee the approval of new acquisitions and to undertake a performance management role. It is proposed that the Board will comprise the Leader of the Council and the Leaders of the two Opposition Groups, the Executive Member for Investment, the Chief Executive and the Corporate Director for Economic Growth Environment and Infrastructure (represented during the current vacancy in that role by the Interim Corporate Lead for Property and Investment). The IMB will act under advisement from the Director of Legal and Democratic Services, Chief Finance Officer and CBRE. This process will be supported by appropriate independent external advice on each acquisition and also a robustness statement from the Chief Finance Officer.
16. The financial performance of the investment portfolio and of each property within the portfolio will be measured and reported on on a quarterly basis by an officer group to the IMB and subsequently to Executive. Performance measurement will be based on external revaluations and net yield generated and reporting will be undertaken with a view to making recommendations concerning sales or purchases and any amendments to the adopted strategy to ensure that the main objectives continue to be achieved.

FINANCE CONSIDERATIONS

17. The budget gap for 2018/19 and 2019/20 reported to Council in February 2017 was £13.2m and £6.1m respectively and these budget reductions need to be seen in the context of savings of £128m which have been made since 2010/11. To help to address this gap the Council has the opportunity to undertake investments which satisfy the investment objectives outlined above and with the aim of generating a revenue return to the Council.
18. All opportunities for investment will be subject to high levels of due diligence and must have a robust business case demonstrating a sustainable income stream sufficient to cover interest costs associated with any borrowing, property management costs and debt repayment provisions, known as minimum revenue provision (MRP).

19. All future acquisitions will be financed through prudential borrowing but the extent that MRP is accounted for will be determined on a case by case basis and be a function of the life and condition of the asset, the lease term of any tenant and estimated residual asset value. The Council is required to charge a prudent provision for debt repayment annually and based on a strategy of acquiring assets with strong residual values the level of MRP is likely to be relatively low. Each year the Council approves its MRP strategy and a further update will be required for the MRP approach for investment property as referred to above.
20. If the properties are to be held directly by the Council then there should be no Corporation Tax or Capital Gains Tax issues arising. If a separate trading company was to be established taxation issues would have to be taken into account in estimating overall returns in respect of investments undertaken through that body. There will be various VAT implications to ensure the optimum arrangement are put in place.
21. Stamp Duty Land Tax will be payable on all purchases.

RISK MANAGEMENT

22. A rigorous assessment of all risks is required for each investment in order firstly to value each property and then to check its suitability for inclusion in the portfolio. The risks fall into two categories, firstly economic and property market risks in specific property market sub-sectors and locations and secondly asset-specific risks including:-
 - Location of property
 - Building specification quality
 - Length of lease unexpired
 - Financial strength of tenant(s)
 - Rental levels payable relative to current open market rental values
 - Residual value
23. Reputational risks will also be considered particularly in relation to the types of commercial properties to be acquired and the type of tenant.

LEGAL IMPLICATIONS

24. Local authorities have broadly drawn powers allowing them to invest and to borrow, in each case either for purposes relevant to the performance of any of their functions or generally for the prudent management of their financial affairs (s1 and s12 of the Local Government Act 2003). They may also acquire property by agreement located either inside or outside of their borough for the purposes of any of their functions, including their investment functions, or otherwise for the benefit, improvement or development of their area (s120 of the Local Government Act 1972). In addition, they may also take any action (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions, which would again include their investment functions (s111 of the Local Government Act 1972).

25. The Council also has powers under the general power of competence contained in section 1 of the Localism Act 2011 (2011 Act) to do anything that individuals generally may do. However, this is not an unfettered power and there is a requirement under Section 4 of the 2011 Act to act through a company where the authority is exercising the general power for a "commercial purpose". "Commercial purpose" is not defined, but it is likely that an investment made solely with a view to a profit would constitute a commercial purpose, even where that investment entailed fulfilling some wider strategic or altruistic purpose.
26. This would mean that if the Council was seeking to invest for commercial purposes, rather than as a result of the exercise of its powers under the Local Government Acts it would be necessary for it to do so through a company. It will therefore be important that any investments acquired pursuant to the strategy are wherever possible acquired relying upon the powers in S1 and S12 Local Government Act 1972.
27. However, in order to facilitate investments made for commercial purposes, authority is also sought for the establishment of a wholly owned investment company. The Council would then be able to engage in investment activity which is not aligned to the exercise of other local authority functions, and which must therefore be deemed to be for a commercial purpose, through the proposed company. This will enable the Council to maximise its access to investment opportunities and to secure opportunities where the sole benefit to be derived from that investment will be a commercial return.
28. The Council will need to ensure that in exercising its investment and borrowing functions to expand its property portfolio, that any actions are reasonable and proportionate and for proper purposes consistent with the Council's prudential regime and its investment strategy. Investment decisions also need to be taken mindful at all times the council's fiduciary duties to ensure the sound management of the public finances.
29. Notwithstanding this judicial discussion, if the purpose of the proposed investment is objectively characterised as a commercial purpose and the Council is relying on the general power of competence in the 2011 Act, rather than any of its other functions then pursuant to s4(2) of the 2011 Act, the Council should only act through the use of a company.
30. Legal due diligence will be required on all property acquisitions, to include a review of title and ownership, and searches and enquiries of the vendor, in order to ascertain relevant liabilities and restrictions connected with the subject property. The results of the legal enquiries, and any associated risks, should be considered prior to any decision to enter into contract.
31. On any sale of an investment property the Council will be required to obtain best consideration in accordance with s123 of the Local Government Act 1972. Usually this will be achieved by placing the property onto the open market or otherwise, in respect of a sale agreed off market, demonstrating by way of professional valuation that it is achieving no less than market value for the property.

PRUDENTIAL INDICATORS

32. There are no overall limits on what a council can borrow but the overall Treasury Management function is governed by Cipfa's Treasury Management and Prudential Codes. Under the latter the Council is required to set indicators that are designed to support and record decisions taken on affordability and sustainability. There is also a requirement to impose *limits* on the Council's treasury management activities to ensure decisions are made in accordance with professional good practice and risks are appropriate (These are included in the Treasury Management Strategy Report). The Chief Finance Officer monitors these and reports on them at appropriate times whilst the Council can revise these indicators and limits at any time.
33. Increasing the Investment Fund has a significant impact on the Council's prudential indicators and updated figures are included in the appendices at Part B to this report. The main changes to the indicators are as follows:-
- An increase to the Capital Programme in 2017/18
 - An increase to the Authorised and Operational Limits
 - An increase to the Capital Financing Requirement
34. It is worth noting that two important indicators relating to the impact of the decision on the council tax level and the financing costs to net revenue stream do not increase as a result of this proposed investment.
35. Other changes to the Treasury Management Investment Strategy around counterparty limits are required to give capacity to invest any surplus short term funds that may be available before investment property acquisitions are made are included within the appendices at Part B to this report.

Other Options

The Council could choose not to increase the Capital Programme but this would limit the opportunities which the Council is able to take in order to support economic growth and regeneration in the Borough and restrict the resources available to acquire a balanced portfolio of investment assets. It would also mean that the ability to generate new sustainable income streams would be missed and the potential to reduce the budget deficit through increased income would be lost.

Consultation

No consultation is required at this stage; each proposal will be subject to appropriate levels of due diligence and assessed to determine any impact and therefore the consultation required.

Reasons for Recommendations

To increase the level of the Investment Fund to allow the Council to invest to support its functions and to secure a balanced portfolio of investment assets which will help in mitigating risk and maximising returns.

Key Decision: No

If Key Decision, has 28-day notice been given?

Finance Officer Clearance (NB)

Legal Officer Clearance (JLF)

Corporate Directors Signature

A handwritten signature in blue ink that reads "Joanne Hyde". The signature is written in a cursive, flowing style.

To confirm that the Financial and Legal Implications have been considered and the Executive Member has cleared the report.