TRAFFORD COUNCIL

Report to: Council
Date: 27th July 2022
Report for: Decision
Report of: Executive Member for Economy and Regeneration

Report Title

Asset Investment Strategy – 2022 update

Summary

The report seeks approval for a proposed update to the Council's Asset Investment Strategy.

The change to the Asset Investment Strategy provides the Investment Management Board (IMB) some discretion when implementing the strategy. The change only relates to debt investments, not direct property investments. This reflects that development projects are complex and that level of risk in a proposal does not always fit neatly within set parameters.

The change will not impact on the Council's overall exposure to risk. Where IMB uses its discretion to make investments that fall outside of the agreed risk parameters, it will be clearly justified and reflect a reduction in risk elsewhere in the investment business case.

The Council's Investment Advisor (currently CBRE) will advise on the overall level of risk in a lending proposal and that any deviation from the "hard" investment parameters is justified by an equivalent reduction in risk elsewhere in the business case.

The Investment Advisor will also advise on the overall level of risk in the Council's asset investment portfolio.

The update will enable the Council to continue to deliver a sustainable investment return and facilitate good quality development in and around Trafford.

Recommendation(s)

That the Council:

- Approves the updated Asset Investment Strategy which is included at Appendix 1.

Contact person for access to background papers and further information:

Name: Richard Roe
Extension: 4265
Background Papers: None

Implications:

Relationship to Corporate Priorities	Supports policy for Economic Growth and Development
Relationship to GM Policy or Strategy Framework	Not applicable
Financial	Supports the successful implementation of the Council's Asset Investment Strategy.
Legal Implications	The current strategy sets hard parameters on the Council's lending strategy which reflect the Council's risk appetite. The update will allow the Investment Management Board to approve investments outside of those parameters where there is justification for doing so.
Equality/Diversity Implications	The purpose of the Investment Strategy is to create a sustainable income to fund local services which will have long term positive impacts on all areas of Council policy.
Sustainability Implications	As above
Carbon Reduction	The strategy gives weight to sustainable investments with carbon reduction credentials.
Staffing/E-Government/Asset Management Implications	Not applicable
Risk Management Implications	Not applicable
Health and Safety Implications	Not applicable

1.0 Background

1.1 The Council on the 26th July 2017 approved an Asset Investment Strategy ("The Strategy"), and the establishment of the Investment Management Board ("IMB") to oversee implementation of the Strategy.

1.2 Since 2017 there have been several updates to the Strategy, most recently in February 2022.

1.3 Regularly reviewing and updating the Strategy is important to ensure that the Council continues to have access to the best investment opportunities and that its exposure to risk is appropriate.

1.4 Over the five years since the implementation of the Strategy there have been several changes including

- Changes to investment zones to favour in-borough investments
- Updated return requirements to reflect changes to the Council's cost of capital
- Changes to risk parameters to reflect the wider economic climate, particularly around COVID-19.
- Provisions for social investments and investments that contribute to the Council's key objectives, including carbon reduction objectives.

1.5 This report proposes a further change to the Investment Strategy that will allow IMB some discretion over individual debt (lending) investments.

2 Details of the Proposed Changes

2.1 There are no changes proposed for direct investments.

2.2 For debt (lending) investments, the strategy is prescriptive about what the Council can and cannot invest in:

Lending Criteria	**Strategy Risk Limit**
Minimum return	PWLB cost of funds + 2.5% pa.
Maximum Loan to Cost (LTC)	80%
Maximum Loan to Value (LTV)	70%
Investment Objective	Must support one or more of the Council's Strategic Priorities
Target transaction size	£20m to £50m
Minimum transaction size	£10m (£5m for in-borough)
Length of investment period	3 years max for single phase
Security	All loans will be senior facilities, with a fixed first charge over the freehold interest.

2.3 These lending parameters work well as a framework to assess the risk of an investment opportunity. The parameters reflect the most common real estate debt investments which tend to be structured in a similar way:

- Debt funding secured against a freehold interest

- 1-3 year loan drawdown period reflecting a standard build programme
- Sponsor putting in between 25-50% equity in the scheme as combination of land and cash
- Build contract in place with reputable contractor
- Planning secured
- Exit pricing supported by market evidence

2.4 Because the strategy is prescriptive with “hard” risk limits, it does not currently allow IMB to make investments that fall outside of these parameters, but that overall have the same or lower level of risk than the rest of the portfolio.

2.5 Three examples are provided as follows:

2.6 **Example 1**: Development loan for a residential scheme to a reputable sponsor.

Fulfils all lending criteria EXCEPT that leverage (LTV) is higher than 70%.

However, there is a contractual commitment from an institutional investor to acquire all units for a fixed price at the completion of the scheme

2.7 In this example, whilst outside of the Strategy limits, the increase in leverage is offset by guaranteed sale proceeds (rather than estimated sale proceeds to multiple end users). So overall, the risk exposure is in line with the Strategy.

2.8 **Example 2**: Development loan for an industrial scheme to a single reputable tenant.

Fulfils all lending criteria EXCEPT the return is marginally below the minimum return.

However, there is a legal contract to purchase in place with a single end user of very strong financial standing.

2.9 In this example, whilst outside of the Strategy limits, the slight reduction in return is offset by guaranteed sale proceeds. So overall, the risk exposure is in line with the Strategy. These scenarios will be considered against the borrowing costs which the Council will pay to ensure there is sufficient headroom over the full length of the loan.

2.10 **Example 3**: Development loan for a residential scheme to a reputable sponsor.

Fulfils all lending criteria EXCEPT that loan to cost ratio (LTC) is higher than 80%.

However, there is a repayment guarantee for a portion of the loan from a sponsor with a strong financial covenant, which would bring the LTC below 75%, if used.

2.11 In this example, whilst outside of the Strategy limits, the increase in leverage is offset by the increased recourse available in a downside scenario. So overall, the risk exposure is in line with the Strategy.

2.12 These examples show that there may be investment opportunities that arise that are outside of the investment parameters, but overall, the risk/ return from the investment does still meet the investment strategy.

3 Governance

3.1 The governance arrangements are extensive and each year the Strategy is updated to take account of professional guidance, specifically the Prudential Code produced by the Chartered Institute of Public Finance and Accountancy. In addition any borrowing undertaken is done so in accordance with the rules operated by the Public Works Loans Board. Regular monitoring of all investments undertaken and reported through the Investment Management Board who receive performance reports from the Council's external advisors throughout the year. Budgetary performance is included within the Council's budget monitoring reports to Executive. The investment activity is also subject to scrutiny from the external auditors as part of the statutory final accounts process.

3.2 IMB is advised by the Investment Advisor (currently CBRE) in relation to the overall investment strategy, and implementation of the strategy. The Investment Advisor is responsible for undertaking full due diligence on all investment proposals.

3.3 The Investment Advisor undertakes two stages of due diligence which is reported to IMB:

- Stage 1 – initial review and assessment of alignment with investment strategy. IMB to consider and approve the commencement of the Stage 2 due diligence (paid for by the borrower).

- Stage 2 – full business case and due diligence including a review of the scheme appraisal, market assessments and contract reviews.

3.4 As part of this process, the Investment Advisor will need to justify and evidence how the overall level of risk in a proposal is in line with, or an improvement on, the intended risk parameters in the existing investment strategy.

3.5 The Investment Advisor will also provide assurance that the overall level of risk in the portfolio is not materially changed by an individual investment.

3.6 It is expected that investments that deviate from the existing investment strategy will be limited, and most investments will still adhere to the agreed parameters.

3.7 The updated strategy is presented at Appendix 1 and the key change is summarised as follows:

"As outlined within this section, the Investment Strategy includes parameters that help guide and inform the nature of Trafford's investments. These parameters include (though are not limited to) risk indicators such as leverage, return hurdles, ESG requirements, geographical constraints etc.

There is, however, an acknowledgement that every transaction is different, and there maybe instances where transactions have characteristics which sit outside of the aforementioned parameters, but which also possess other qualities which, when viewed on balance, help mitigate this non-compliance with the strategy. In these instances, the Investment Strategy should provide some flexibility to assess the transaction holistically and across all of its characteristics, and support those which are deemed to meet the aims and objectives of the Investment Strategy and at no extra risk (as advised by CBRE). This should also be analysed on a portfolio level against the Council's existing investments."

3.8 This provides IMB with the discretion to waive one or more of the agreed parameters, providing the Investment Advisor has given sufficient justification that the risk of the proposal is still in line with the investment strategy.

4 Financial Implications

4.1 The risks associated with the changes above will be considered on a case-by-case basis. All returns from the investments will need to be commensurate with the risks involved in each transaction and be sufficient to cover any financing costs to the Council and provide a suitable return to support the cost of Council services.

5 Other Options

5.1 Council could decide not to amend the investment strategy. This would result in potential sustainable investment opportunities being missed if they are outside of the agreed investment parameters.

6 Consultation

6.1 Not required

7 Reason for Recommendations

7.1 The updated Investment Strategy allows some flexibility for IMB to make investment outside of the parameters in the agreed investment strategy. These will always be supported by written advice from the Investment Advisor as part of the due diligence process. This will create more investment opportunities for the Council and maximise the chances of securing good sustainable development in the Borough.