Investment Strategy

Introduction

The Council is required to prepare an Investment Strategy for each financial year.

As the Treasury Management Strategy covers the Council's cash investments this strategy covers all non-cash investments.

This strategy sets out the investments the Council holds and the underlying principles supporting those investments and the decision making process for investing.

It places the Council's investments into the context of its overall financial position, outlines the contributions that the different investments make to service delivery and gives an indication of the performance of those investments i.e. its loans and commercial property investments.

The Investment Strategy is formally approved by full Council each year, in advance of the 1 April.

Overview of Investments

The Council holds a number of different investments which can be classified into two main categories:

- Investments held for treasury management purposes; and
- Other investments; typically for Broxbourne these tend to be commercial properties and loans to subsidiary companies

Investments held for treasury management purposes

The Council usually receives its income from collecting council tax and business rates and income from fees and charges before it pays for its expenditure in cash (e.g. paying staff and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of Hertfordshire County Council, the Police and Crime Commissioner and central government. The timing of these activities often results in a cash surplus, which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA).

These are the Council's treasury management investments.

They range from short term investments in money market funds to longer term investments with other local authorities or established financial institutions.

The principles which underpin these investments are contained with the Treasury Management Strategy which is approved by the Council each year.

Other investments

All non-treasury management investments the Council holds and makes are categorised as other investments.

The Council's other investments can be further categorised into the following groups:

- Investment properties

  The Council has a portfolio of investment properties. These are properties which are held purely for their capital value and the rental income they generate. They are not used to deliver services. The properties in the portfolio can be split into two groups – those that have been owned by the Council for many years (referred to as legacy investment properties in this Strategy) and those which have been purchased more recently by the Council.

- Loans to wholly-owned companies

  These are long-term loans made to the Council's wholly-owned subsidiary company Badger BC Investments Ltd (Badger).

- Loans to other third parties

  The Council has made loans to other third parties, including local organisations and businesses. These are usually of relatively low value, with shorter repayment terms.

Full details of all the non-treasury investments the Council holds can be found at appendix A.

For the purposes of this Strategy, 'other investments' will be simply referred to as 'investments'.

Contribution to Service Delivery Objectives

All investments the Council holds should contribute in some way to the Council's service delivery objectives and help to achieve the Council's corporate objectives and priorities as defined in its Corporate Plan.

The contribution of the Council's investments to these objectives will not always be direct i.e. they may generate income which supports services across the Council which deliver the corporate priorities but it is not possible to draw a straight line from that income to the service outcomes.

Therefore, in order to allow a clear understanding of how investments contribute to service delivery objectives, the following distinct categories of how an investment can support the Council's objectives, have been devised:

- Yield or profit

  The investment generates significant annual income which is used to protect and support services. The income is not ring-fenced in any way and is included in the Council's annual revenue budget.

- Thriving local economy

  The investment supports the Council's economic development ambitions, local businesses and jobs, principally by providing accommodation and infrastructure.

- Economic benefit or business rate growth

  The investment has assisted in creating new opportunities for local businesses or has increased the Council's business rates base. These investments will generally be linked to projects or developments promoted by the Local Plan.

- Respond to local market failure

  There may be instances where the Council needs to step in and invest in a development or other entity within the Borough where, without Council support, the impact on the local economy would be detrimental.

- Regeneration

The investment will help (or has helped) to drive regeneration. There will generally be a link to the Local Plan when this type of investment occurs.

Appendix A details which of the above objectives the Council's investments meet. Where appropriate, investments with similar characteristics have been grouped together. It is possible for individual investments to meet more than one objective.

Quantitative Indicators

The Council has established a set of indicators which allow Councillors and the public to assess the Council's risk exposure as a result of its investment decisions.

As well as giving an overview of the performance of the Council's investments, these indicators allow an assessment to be made of the Council's total risk exposure as a result of its investment decisions.

Appendix B shows the performance indicators for the current period. Where appropriate, a target has been included.

The indicators included are as follows:

- Investment cover ratio
  This ratio compares the total net income from property investments to any interest costs associated with borrowing to make those investments. This demonstrates the Council's ability to meet borrowing costs. This ratio has been included in the Strategy.
- Loan to value ratio
  This is the amount of debt the Council currently has compared to the total asset value. In this instance, the asset value is the total value of the Council's commercial property portfolio. This illustrates whether or not the Council has assets of sufficient value to repay debt if required. This ratio has been included in the Council's Strategy.
- Target income returns
  Net revenue income from commercial properties compared to the value of the property portfolio. This represents the yield of the portfolio as a whole – generally, the higher the percentage the better the performance of the portfolio. However, the better the quality of the asset and the tenant, the lower the yield is likely to be. Therefore, a balance needs to be struck between high yield and good quality assets. This is a ratio the Council already uses to measure the performance of its assets and therefore this has been included in the Strategy.
- Gross and net income
  The income received from the Council's investment portfolio at a gross level and a net level (after the deduction of costs) over time. This will increase as the portfolio expands and achievable rents increase. This indicator is included in the Strategy.
- Operating costs

  This is the trend in operating costs of the property portfolio over time. It gives an overview of the impact of commercial property investments on the costs of running the portfolio. This indicator is included in the Strategy.

- Property vacancy levels

  The lower the level of vacant properties (voids) the better the property portfolio is being managed to ensure that rental income is maximised as much as possible. This indicator is included in the Strategy.

Guiding Principles for Investments

Security and yield are the underlying objectives of all financial investments made by the Council. This means that the safety of the Council’s money is the main criteria considered when deciding whether to make an investment.

Liquidity for financial investments

The yield (or return on investment) is only considered once the appropriate level of security has been determined and satisfactorily met by the proposed investment. However, it is possible for the relative balance between these principles to differ depending on the nature and objectives of the individual investment being made.

The Council as a lender

The Council can provide loans to its wholly owned subsidiaries, local businesses and other bodies.

As at 31 March 2020 the Council had outstanding loans to its subsidies and other organisations of £10.4 million. These loans are detailed in appendix C.

The Council has set a limit of 15% of the value of its net assets excluding long-term debtors as the total exposure that it is willing to have to loans of this nature to organisations other than its wholly owned subsidiary company. There will be no restriction on the value of loans to the wholly owned subsidiary companies.

Loans to Wholly-Owned Subsidiaries

The Council makes loans to its wholly-owned subsidiaries for two purposes to:

- provide working capital
- provide funding for the purchase or construction of properties (the loans are secured against these properties)

All loans made to wholly owned companies are made at market rates (currently 4%).

The main risk to the security of the Council’s funds when making loans is that the borrower will be unable to repay the principal lent or the interest as it falls due. In order to mitigate this risk, the Council assesses the risk of loss before entering into any loan agreements.

In the case of loans to wholly owned subsidiaries, the risk of non-repayment is considered to be low, as the Council has full control over the companies and can compel them to repay any outstanding balances if required. It can do this by forcing the company to sell its assets and repay the outstanding loans. Badger BC Investments Ltd currently holds assets to the value of £12.4m with outstanding loans of £10.3m.

For loans to other organisations, where appropriate, credit references are taken to allow an assessment of credit worthiness to be made. In addition, the nature and operating environment of the organisation which will receive the loan is used to inform a decision about whether to advance any funds.

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The Council makes reasonable efforts to collect the full sum lent and has appropriate arrangements in place to recover overdue repayments. These are set out in the Council's Sundry Debt Recovery Policy.

Commercial Property

The Council invests in commercial properties for the sole purpose of using the income from these properties to fund services and projects. It chooses to do this in preference to reducing or cutting services, which would be necessary in order to set a balanced budget when expenditure is increasing due to inflationary pressures and changes in demand for services and government funding is reducing. Commercial property investments are secure as they are valued in the Council's accounts at or higher than their purchase cost.

A fair value assessment of the Council's investment properties was made as part of the preparation process of the 2019/20 statement of accounts indeed a fair value assessment is carried out every year as part of this process and the underlying assets provide security for capital investment. It is not expected that it will but should the 2020/21 year end accounts preparation and audit process value these assets below their purchase cost, then an updated investment strategy will be presented detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Before any new investment in commercial property is made, in order to mitigate the risk of loss from the investment, a number of factors must be considered and the criteria relating to these factors must normally be met by the potential investment for it to be pursued. If a proposed investment does not satisfy all the criteria it may still be pursued, but an explanation of why it is considered a suitable investment despite not meeting all the criteria will be provided as part of the business case for final approval.

The factors to be considered for property investments are as follows:

- Market value

  External advice is sought to gain assurance over the market value of a potential purchase to ensure that the price sought by the vendor is not overvalued. This advice is provided by companies such as Lambert Smith Hampton, CBRE and Allsops. It includes an analysis of current value and what possible uses are available for the property or site if the current tenant vacates. This enables the Council to take a view on future values in the event of a change in circumstances.

- Credit rating of the tenant

  The strength of the existing tenant(s) within a proposed acquisition is assessed. A strong tenant is important as there is less chance of them defaulting on lease payments (rent) and thereby putting the Council's income stream at risk. Credit reference agencies such as Creditsafe and Equifax along with Companies House searches are used to carry out this area of due diligence.

- Length and terms of the lease

  In order to minimise the risk of rental values going down following the renegotiation of a lease, the Council looks to invest in properties which have long term leases in place, with a significant portion of the lease period remaining. The Council also ensures that leases place the onus for insurance, repairs and maintenance on the tenant so that the Council does not incur any additional or unforeseen costs.

- Location

  A small number of properties in the Council's portfolio are located outside the Borough. This mitigates against any risks associated with isolated local swings in rental demand creating a diverse portfolio of investments.

  An assessment of the vibrancy of the area in which a potential purchase is located is carried out and this includes the level of economic investment, regeneration projects and the existence of good transport links. Where necessary, experts with local knowledge of the area will be engaged to assist with this assessment.

- Diversity of the commercial property portfolio

  To minimise the risk of changes in the performance of particular sectors of the commercial property market (i.e. the retail, office and industrial sectors) impacting on the Council's income, investment decisions are taken in the context of the existing nature of the portfolio and whether or not the property to be acquired complements the existing mix of portfolios. The Council will seek to maximise the diversity of its overall portfolio and not concentrate new investments in any one sector or area.

- Yield

  The Council will consider the return it will get on its investment (the yield). The Council has a minimum yield expectation of 6% and will only invest in a property below this level if it fulfils other strategic interests. The yield calculation takes into account any costs incurred if the investment is to be funded by prudential borrowing.

Compared with cash investments, property is relatively more difficult to convert to cash at short notice and market conditions can impact on how long a sale can take. In order to mitigate against this, the diversity of the portfolio will be maintained to ensure that if there is a need to sell an asset to release cash, the Council can take advantage of the different market conditions for the different sectors. In the short term, if cash is needed, the Council maintains a prudent level of reserves and therefore, has other cash investments which could be realised to cover any gap between the need for cash to repay debt and the sale of any asset.

Proportionality

The Council uses the income from its commercial property investments to achieve a balanced revenue budget. The table below shows the extent to which the Council's planned revenue expenditure is dependent on income from commercial property over the lifecycle of the Medium Term Financial Strategy.

The Council sets its budgets for rental income inclusive of a provision for empty (void) periods. This ensures that the budget remains achievable.

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
	£000	£000	£000	£000	£000	£000
Net service expenditure*	23,395	26,490	27,281	27,821	28,383	28,951
Commercial rent income	7,486	7,779	8,801	8,977	9,157	9,340
Proportion	32%	29%	32%	32%	32%	32%

* Net service expenditure is the Council's gross expenditure, less income from government grants, sales and fees and charges

In the unlikely event that rental income drops below the budgeted level the Council has sufficient reserves in place which could be used to address a short term short-fall in income. In the longer term, the Council continues to review its services and identify other ways of reducing costs and identifying sustainable income streams to ensure the ongoing ability to set a balanced budget.

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 Council does not profit from any sums received from investment properties. All income from investment properties is used to fund services provided to its local tax payers or to fund its capital programme, no sums are set aside in the reserves. The Council makes proportionate and prudent investments in property to generate long term sustainable revenue income streams. The Council's policies in investing the money borrowed are outlined above.

Capacity, Skills and Culture

Statutory Officers

The Council's statutory officers are all experienced, and where appropriate qualified, local government officers. They are supported by a variety of qualified professionals with expertise in property, town planning, law, treasury management and finance. This allows them to make informed decisions and understand the risks and opportunities associated with those decisions.

Elected Members

It is important that elected members understand the decisions they are asked to make relating to investments. All reports to members are written in plain English with any technical language kept to a minimum.

In order to ensure that members have the knowledge and skills required to support them in their decision making role, a series of training events have been developed which cover areas such as Local Government funding and accounting and risk.

Non-Treasury Management (Other) Investments

	Value @ 31 March 2020 £	Funded By	Contribution: Yield / Profit	Thriving Local Economy	Economic Benefit / Business Rate Growth	Respond to local market failure	Regeneration
Loans							
Wholly-owned subsidiary							
Badger BC Investments *	10,252,477	Capital Receipts	✔	✔	✔		✔
Other Organisations							
Hertfordshire Building Control Ltd	107,000	Capital Receipts		✔			
Broxbourne Trustees of Open Space	75,708	Capital Receipts					✔
Total loans	**10,435,185**						
Non-Financial Investments (Property)							
Legacy - Leisure	2,239,045	Capital Receipts			✔		
Legacy - Industrial	35,741,652	Capital Receipts		✔	✔		
Legacy - Offices	396,650	Capital Receipts		✔	✔		
Legacy - Retail	5,968,638	Capital Receipts		✔	✔		
Legacy - Residential	13,500	Capital Receipts		✔			
Fawkon Walk	5,888,414	Capital Receipts				✔	✔
Market Street, Hertford	894,253	Capital Receipts	✔				
DVLA Bangor	2,285,988	Capital Receipts	✔				
Oxford Street, High Wycombe	1,427,701	Capital Receipts	✔				
Dereham Road, Norwich	1,156,855	Capital Receipts	✔				
5 Burnt Oak Broadway	1,780,238	Capital Receipts	✔				
Victoria Street, Grimsby	16,158,390	Borrowing	✔				
Stephenson's Close, Hoddesdon	4,475,489	Borrowing			✔		
Turnford Place, Turnford	18,016,742	Borrowing			✔		
139-149, 151 & 153 High Street, Waltham Cross	3,705,253	Borrowing				✔	✔
Waltham Cross Pavilions **	13,403,772	Borrowing				✔	✔
Total Non-Financial Investments	**113,552,580**						
Total Investments (excl Treasury Management)	**123,987,765**						

* value at 31 March 2020
** purchase value

Investment Strategy Performance Indicators 2019/20 to 2021/22

Investment cover ratio

This ratio compares the total net income from property investments to any interest costs associated with borrowing to make those investments. This demonstrates the Council's ability to meet borrowing costs.

	2019/20	2020/21	2021/22
	Actual	**Forecast**	**Estimate**
	£000	**£000**	**£000**
Commercial rent income	7,486	7,780	8,802
Interest payable	474	420	35
	1580%	**1852%**	**25148%**

Loan to value ratio

This is the amount of debt the Council currently has compared to the total asset value. In this instance, the asset value is the total value of the Council's commercial property portfolio. This illustrates whether or not the Council has assets of sufficient value to repay debt if required.

	2019/20	2020/21	2021/22
	Actual	**Forecast**	**Estimate**
	£000	**£000**	**£000**
Borrowing	39,550	44,120	57,650
Value of investment property portfolio	93,357	97,062	113,553
	42%	**45%**	**51%**

Target income returns

Revenue income from commercial properties compared to the value of the property portfolio. This represents the yield of the portfolio as a whole – generally, the higher the percentage the better the performance of the portfolio. However, the better the quality of the asset and the tenant, the lower the yield is likely to be. Therefore, a balance needs to be struck between high yield and good quality assets.

		2019/20	2020/21	2021/22
	Target	**Actual**	**Forecast**	**Estimate**
		£000	**£000**	**£000**
Commercial property rental income		7,486	7,780	8,802
Value of investment property portfolio		93,357	97,062	113,553
	6%	**8.0%**	**8.0%**	**7.8%**

Commercial property income

The income received from the Council's investment portfolio at a gross level and a net level (after deducting costs) over time. This will increase as the portfolio expands and rents increase.

	2019/20	2020/21	2021/22
	Actual	**Forecast**	**Estimate**
	£000	**£000**	**£000**
Property services gross income	7,955	8,107	9,236
Property services net income	6,029	6,310	7,169

Operating costs - property services

This is the trend in operating costs of the property portfolio over time. It gives an overview of the impact of commercial property investments on the costs of running the portfolio.

	2019/20	2020/21	2021/22
	Actual	**Forecast**	**Estimate**
	£000	**£000**	**£000**
Operating costs	1,665	1,558	1,827

Property vacancy levels

The lower the level of vacant properties (voids) the better the property portfolio is being managed to ensure that rental income is maximised as much as possible.

2019/20	2020/21	2021/22
Actual	**Forecast**	**Estimate**
6%	6%	6%

Loan Book

	Total Loan Outstanding 31/03/2020 £
Wholly-owned subsidiary	
Badger BC Investments	10,252,477
Other Organisations	
Hertfordshire Building Control Ltd	107,000
Broxbourne Trustees of Open Space	75,708
Total Loan Book Value	**10,435,185**