Appendix 2

WORCESTER CITY COUNCIL

INVESTMENT STRATEGY

2024/25 -2026/27

DRAFT

March 2024

Introduction

This Investment Strategy fulfils the requirement, under statutory guidance published by the then Ministry for Communities and Local Government (MHCLG) in January 2018, to provide an overview of proposed service and commercial investments planned to be undertaken during 2024/25.

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).

This investment strategy focuses on the second and third of these categories.

Treasury Management Investments

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 and central government. 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 (CIPFA). The balance of treasury management investments is expected to fluctuate between £10m and £35m during the 2024/25 financial year.

The contribution that these investments make to the objectives of the Council is to support effective treasury management activities. Full details of the Council's policies and its plan for 2024/25 for treasury management investments are covered in a separate document, published as an appendix to the Budget Report.

Service Investments: Loans

The Council has the opportunity to lend money to suppliers, local businesses, local charities, housing associations, local residents, its employees and its subsidiaries (should it have any) to support local public services and stimulate local economic growth. The Council has agreed to provide loan facilities to four community projects in order to unlock developments which might not otherwise have been possible.

- Worcester Citizens Swimming Baths Association - £97,800 to repair and improve the facilities at Lower Wick swimming pool
- Worcestershire Football Association – Up to £700,000 for the development of the Headquarters and football facility at Claines lane
- Worcester Hockey and RGS Worcester – Up to £2.1m for the development of a new hockey facility to replace current deteriorating facilities
- Worcester Kiln - £20,000 to facilitate the provision of workspace in the city centre for small businesses

No new loans were approved during 2023/24 although the loan facility to Worcester Hockey has not been drawn down at the date of this report.

In each case the intention is to further the aims of the City Plan and use the Council's existing reserves, or its capacity to borrow, to support these objectives. In doing so the Council must have regard to regulations, CIPFA guidance, and legislation relating to State Aid or the UK Subsidy Control regime which replaced the State Aid rules from 1 January 2023. Under these rules the Council cannot use public funds above certain financial limits to provide an advantage to a commercial entity which would otherwise need to obtain financing at market rates.

The main risk when making service loans is that the borrower will be unable to repay the principal loaned 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 need to be set. Table 1 shows upper limits on lending by type of provider.

Table 1: Loans for service purposes

Category of borrower	**Proposed Limit 2024/25 £m**
Local charities	4.0
Housing associations	3.0
TOTAL	**7.0**

Accounting standards require the Council to set aside 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 in the event that loans are made. However, the Council makes every reasonable effort to collect the full sum loaned and has appropriate credit control arrangements in place to recover overdue repayments.

The Council will assess the risk of loss before entering into, and whilst holding, service loans by detailed scrutiny of proposed cashflows of the loanee and by annual review of the loan arrangement. Individual reports for each proposal will set out overviews of such cashflows and identify potential risks in advance of any decision to proceed. All such decisions will be subject to agreement by the Policy & Resources Committee.

The following principles will form part of this strategy:

- Independent external advice will be sought and considered prior to provision of such loans
- Credit ratings will be used to assess risk where these are available and company financial assessments where appropriate
- Loans will be secured against appropriate assets and/or subject to guarantees in the event of default

The statutory guidance requires that the Council set limits on shares and other non-specified investments. The Council currently does not hold shares in third parties or subsidiaries and has no plans to make such investments, other than investment in the CCLA Property Fund. Investment in the fund as at 31 March

2024 is approved in accordance with the report agreed by the Income Management Sub-committee at its meeting of 16 January 2018 with a maximum proposed investment of £5m. The current level of investment is £3m which is expected to generate a return of £130,000 (4.33%) in 2023/24.

Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. 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.

Commercial Investments: Property

Statutory accounting definitions hold property to be an investment when it is held primarily for commercial purposes: i.e. to generate a profit. DLUHC guidance defines property to be an investment if it is held primarily *or partially* to generate a profit.

The Council has existing investments in local commercial and residential property, which are held for a variety of reasons, according to historical decisions. The income derived from these sources in 2024/25 is budgeted to be £1.230m as set out in Table 2 below.

Table 2: Income from existing 'commercial' holdings

Type of holding	**Annual income (£)**
Industrial Estates	185,300
Markets	42,000
Offices	882,650
CCLA Property Fund	120,000
Total	**1,229,950**

Excluding those sites which are purely held for service delivery purposes, the book value of the investments defined as 'commercial investments' for accounting purposes during 2024/25 is £19.182m, providing a gross income of £1,229,950 p.a., which is a gross return of 6.4%.

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.

Should the year-end accounts preparation and audit process value such properties below their purchase cost, this will be reported as part of the year-end closure process and the impact detailed as part of the outturn report for that year.

The Council assesses the risk of loss before entering into, and whilst holding, property investments by reviewing the expected cash flows for each scheme under three scenarios: best, standard and worst case. The Commercial Strategy requires that only projects which meet the following criteria will be actively considered:

- The projected cash flows result in a positive outcome over the lifetime of the project under all recognised scenarios

- There is a positive return to the MTFP over the lifetime of the project
- There is a positive return, including use of contingencies, over the first five years.

While the Council, in line with revised guidance, no longer seeks to procure property purely for the purposes of generating an investment return, these criteria will continue to be used in consideration of the purchase price of properties that are acquired in support of the Council's broader aims and to inform financial planning.

Non-financial risks will be assessed in accordance with the Council's risk assessment procedures and a risk register compiled for each viable project that meets the qualification criteria established above.

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. As the Council proposes to undertake such investment primarily for regeneration purposes, the option to sell the asset to recover costs must be balanced against the need to retain the asset to secure the development potential. The resale value is considered as part of the risk assessment for each proposal.

Should the costs of investment properties outweigh the income required to meet the financing costs of the investment, the Council will follow the strategic approach set out in its Commercial and Asset Management Framework approved by the Policy and Resources Committee on 29 October 2018. This requires that all assets, including commercial assets, are subject to a cyclical 'fit for purpose' review that 'invest or dispose' decisions are taken in the light of that review.

Loan Commitments and Financial Guarantees

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. These differ from service loans, outlined above, as they do not represent loans by the Council to third parties to support service delivery objectives as set out in the City Plan, Masterplan and Business Plan but underwriting financial commitments by third parties.

The Council has no existing contractual commitments to make financial guarantees to any organisations and does not propose to make loan commitments at this stage. The Council did make guarantee arrangements under the Local Council Mortgage Scheme (LAMS) but this scheme has now closed and all potential liabilities have ceased.

Proportionality

The MTFP approved by Council at its meeting in February 2018 included proposals for generating additional income from new sources amounting to £200,000 per annum from 2019/20. Properties acquired under this approach now form part of the portfolio of investments. A measure of risk in the portfolio is the extent to which the council is dependent in investment income to sustain ongoing revenue budgets.

Table 3 shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net surplus from current 'commercial property' investments over the lifecycle of the Medium Term Financial Plan. It can be seen from the table that there is currently only a marginal reliance on income from these sources. There are no significant plans to acquire further properties for this purpose from 2024/25.

Table 3: Proportionality of existing 'commercial investments'

	2022/23 Actual £'000	**2023/24 Forecast £'000**	**2024/25 Forecast £'000**	**2025/26 Forecast £'000**	**2026/27 Forecast £'000**
Gross service expenditure	29,830	25,695	27,282	27,046	27,891
Net return	1,110	1,119	1,119	1,119	1,170
Proportion	3.72%	4.35%	4.10%	4.14%	4.19%

Borrowing in Advance of Need

DLUHC 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 will not borrow purely for the purposes of investing to generate a profit but will seek to secure a reasonable return on its strategic investments. In a report to Policy And resources Committee on 30 July 2018, the Council agreed an approach to acquiring properties for investment purposes. Paragraph 3.4 of the report is as follows:

To progress its intentions under the October 2016 Cabinet report, therefore, the Council will need to ensure that either it invests existing resources in commercial activity (i.e. does not enter into borrowing for the purpose) and/or ensures that the investment is not solely for the purposes of generating profit. Currently, local authorities can purchase land, either within or outside the local authority area, 'for the purposes of....the benefit, improvement or development of their area' under Section 120 of the 1972 Local Government Act. The purchase and development of both land and building assets 'to encourage economic growth and a healthy and more active population' can be done under the general power of competence as these form part of the stated intentions in the approved City Plan.

Where the Council purchases property in order to meet the above objectives it must continue to assess the risks from a financial point of view as well as risks relating to the objectives of the purchases, such as whether the development proposals are achievable. The Council's policies in investing the money borrowed, including management of the risks, for example, of not achieving sufficient income to cover borrowing costs:

- Maintain an overall limit on borrowing for property investments

- Budget on the basis of best-, standard- and worst-case scenarios to ensure that income continues to exceed costs under all scenarios
- Undertake 'fit for purpose' reviews in line with the Capital and Asset Management Framework annually for investment properties
- Maintain adequate investment and sinking funds for each asset to mitigate additional losses
- Set an appropriate 'proportionality cap' to moderate the extent to which the Council becomes reliant on such income. It is proposed that this cap be retained at 5% for 2024/25 in respect of the 'proportion' row identified in Table 3.

Capacity, Skills and Culture

The decision to acquire land or property must be on the basis that it is a sustainable investment and therefore will be capable of generating an annual revenue return or a realisable capital receipt at a later date. The Council could take the decision to invest in property for the furtherance of the City Plan aims without expectation of a financial return but would at least need to realise the value of any purchase in its balance sheet. As this will require a clear decision-making rationale, the 2018 report set out a two-stage decision-making process to ensure that those responsible for making the decision had sufficient sight of the proposal:

- Stage 1: assess the potential of the proposed site both in terms of its contribution to the Council's aims and in terms of its financial return and make a conditional offer;

- Stage 2: Undertake due diligence work and formally approve/reject purchase.

The Policy & Resources Committee will make the final decision on the basis of the above work. All proposals are subject to:

- Detailed review of proposed cashflows under best, standard and worst case scenarios

- Consideration of independent advice from third party experts on the viability of the scheme and the assessment of value

- Formal asset surveys and legal assessment to identify any risks inherent in the scheme.

The indicators set out in this Strategy and the requirements of reporting in each individual proposal will ensure that elected members and statutory officers involved in the investments decision-making process have appropriate capacity and information to enable them to:

- take informed decisions as to whether to enter into a specific investment

- assess individual assessments in the context of the strategic objectives and risk profile of the local authority

- enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

All decisions will be taken in line with this strategy , the Commercial and Income Generation Strategies and the Capital and Asset Management Framework to ensure that due regard is made to statutory guidance as summarised in these documents, risk management, the possibility of financial loss and accountability for decision–making in respect of commercial investments.

<u>Investment Indicators</u>

It is proposed to 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. Annual reports are proposed but more frequent reporting will be considered following regular risk assessment of the investment portfolio.

Total risk exposure: This 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
    - Hockey Centre £2.1m, security to be held over the site covering the value of the loan. Risk therefore nil.

- the value of loans to be written off if the borrower were to default. This would be net of the amount realised from the sale of any land or property held as security;
    - Worcestershire FA re site at Claines £0.70m, security to be held over the site covering the value of the loan. Risk therefore nil.
    - Lower Wick swimming pool £0.1m. Risk £0.1m
    - Worcester Kiln £0.02m. Risk £0.02m

- any guarantees the Council has issued over third-party loans – none

- loss of rental income if the Council's tenants were to default and no replacement tenant could be found for up 12 months.

The last of these is now assessed as part of the scenario assessment for each proposal. Specific risks relating to potential void periods, including those in excess of 12 months, are assessed and any proposals which do not meet the risk criteria set out in the Commercial Strategy are disregarded. To calculate an overall risk for the portfolio, the assessed risks for each proposal can be taken in aggregate and then moderated, over time, by past fluctuations in income or more detailed knowledge. The following table shows the current aggregate estimated risk of commercial property on this basis.

Table 5: Estimated risk of Commercial Property investments

Category	Budgeted revenue 2024/25 £000	Calculated risk	Potential revenue risk £000
Commercial property pre 2020/21	227	5%	11
CCLA Property Fund	120	5%	6
Development Fund	883	25%	221
Total risk exposure	**1,230**		**238**

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.

Since April 2007 the Council has not funded any investments through borrowing. Prior to that date, the cumulative figure for the underlying need to borrow does not provide granular analysis to identify individual assets.

During 2019 and 2020 the Council invested £15.9m in investment properties. Analysis of the Council’s Capital Financing Requirements and underlying cash balances following these investments resulted in the decision to borrow £6m in April 2020 and a further £7m in March 2021. However, as noted above, these financing decisions are not directly related to the investment property purchases.

In November 2020, HM Treasury published proposals to limit the use of PWLB loans for investment purposes with immediate effect. This ruling means that the PWLB will not lend to a local authority that plans to buy investment assets primarily for yield in their capital plans, regardless of whether the transaction would notionally be financed from a source other than PWLB. This effectively disbars the Council from investing in properties for commercial purposes if it intends to continue to use PWLB loans where there is any proposal within the Medium term Financial Plan.

The Council will continue to use PWLB financing for properties acquired for reasons other than primarily for investment and will therefore continue to report on the financing of the capital programme and the impact of property acquisitions, for whatever purpose.