

Southampton City Council

NON-TREASURY INVESTMENT STRATEGY

2024/25

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	<u>SECTION 1 – INTRODUCTION</u>
1.1	Background
1.1.1	<p>The Council invests its money for three broad purposes:</p> <ul style="list-style-type: none"> • it has surplus cash because of its day-to-day activities, for example income 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). <p>This investment strategy meets the requirements of statutory investment guidance issued by the government in January 2018 and focuses on the second and third of these categories.</p>
1.1.2	<p>The statutory guidance defines investments as “all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios.” The council interprets this to exclude (a) trade receivables which meet the accounting definition of financial assets but are not investments in the everyday sense of the word and (b) property held partially to generate a profit but primarily for the provision of local public services. This aligns the council’s definition of an investment with that in the 2021 edition of the CIPFA Prudential Code, a more recent piece of statutory guidance.</p>
	<u>SECTION 2 - TREASURY MANAGEMENT INVESTMENTS</u>
2.1	Background
2.1.1	<p>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. 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 forecast to be £38M at the end of 2024/25.</p>
2.1.2	<p>The contribution that these investments make to the objectives of the council is to support effective treasury management activities.</p>
2.1.3	<p>Full details of the council’s policies and its plan for 2024/25 for treasury management investments are detailed in the treasury management strategy.</p>
	<u>SECTION 3 - SERVICE INVESTMENTS: LOANS</u>
3.1	Background
3.1.1	<p>The Council can lend money to its subsidiaries, its suppliers, local businesses, local charities, housing associations, residents, and its employees to support local public services and stimulate local economic growth. The Council does not currently have any service loans.</p>

3.2	Security - Loan Limits															
3.2.1	The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. 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 in Table 1 below.															
3.2.2	<p>Table 1 – Loans for service purposes £M</p> <table border="1" data-bbox="304 499 1265 831"> <thead> <tr> <th data-bbox="304 499 778 611">Category of Borrower</th> <th data-bbox="778 499 1027 611">31.03.2023 Net showing in accounts</th> <th data-bbox="1027 499 1265 611">2024/25 Approved Limit</th> </tr> </thead> <tbody> <tr> <td data-bbox="304 611 778 667">Subsidiaries</td> <td data-bbox="778 611 1027 667">-</td> <td data-bbox="1027 611 1265 667">2.00</td> </tr> <tr> <td data-bbox="304 667 778 723">Suppliers</td> <td data-bbox="778 667 1027 723">-</td> <td data-bbox="1027 667 1265 723">2.00</td> </tr> <tr> <td data-bbox="304 723 778 779">Other Public Sector Bodies</td> <td data-bbox="778 723 1027 779">-</td> <td data-bbox="1027 723 1265 779">20.00</td> </tr> <tr> <td data-bbox="304 779 778 831">Charities</td> <td data-bbox="778 779 1027 831">-</td> <td data-bbox="1027 779 1265 831">0.50</td> </tr> </tbody> </table>	Category of Borrower	31.03.2023 Net showing in accounts	2024/25 Approved Limit	Subsidiaries	-	2.00	Suppliers	-	2.00	Other Public Sector Bodies	-	20.00	Charities	-	0.50
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3.2.3	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 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.															
3.3	Potential Loan Criteria & Risk Assessment															
3.3.1	<p>The Council does not currently have any material loans but loans to subsidiaries may be considered in the future, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity. Such loans would need to satisfy the following criteria:</p> <ul style="list-style-type: none"> • The loan for expenditure which would, if incurred by the Council, be capital expenditure, • The use of the loan is consistent with the Council's corporate / strategic objectives and priorities, • Due diligence conducted confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term, and • A formal loan agreement is put in place which stipulates the loan period, repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund and takes appropriate account of state aid rules) and any other terms that will protect the Council from loss. 															
3.3.2	The Council would assess the risk of loss before entering and whilst holding service loans. It is likely that should loans granted in the future an external advisor would be engaged to undertake an assessment of the market and relevant credit ratings. These ratings would be monitored, and appropriate action taken swiftly should they change.															

	Should the Council consider any service loans in the future a robust procedure will be developed and reported to Council as an update to this strategy.																																
	<u>SECTION 4 - SERVICE INVESTMENTS: SHARES</u>																																
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4.1.1	The Council can invest in the shares of its subsidiaries, its suppliers, local businesses, local charities, housing associations, residents, and its employees to support local public services and stimulate local economic growth.																																
4.1.2	One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. The Council does not currently have any material investment in shares nor is there any intention to do so at present. If this changed the Council would undertake a risk assessment before entering not a purchase and would establish appropriate Prudential Indicators.																																
	<u>SECTION 5 - COMMERCIAL INVESTMENTS: PROPERTY</u>																																
5.1	Background																																
5.1.1	<p>The Council was able to invest in local, regional and UK commercial and residential property with the intention of making a profit to be spent on local public services. Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment used to fund council services, known as the Property investment fund (PIF). The council purchased three properties; details are in table 2 below.</p> <p>These properties are forecast to generate £1.8M income in 2023/24 a return of 2.13% against the amount invested.</p> <p>There is no intention to purchase any further investment properties, in line with recent updated CIPFA guidance.</p>																																
5.1.2	<p><i>Table 2: Property Investment Fund £M</i></p> <table border="1"> <thead> <tr> <th rowspan="2">Property</th> <th rowspan="2">Actual</th> <th colspan="2">31.03.2023 Actual</th> <th rowspan="2">Outstanding Debt 31.03.2023</th> <th rowspan="2">Outstanding Debt 31.03.2024</th> </tr> <tr> <th>Value in Accounts</th> <th>Cumulative Gain or (Loss)</th> </tr> </thead> <tbody> <tr> <td>Property 1</td> <td>6.47</td> <td>4.79</td> <td>(1.68)</td> <td>5.81</td> <td>5.74</td> </tr> <tr> <td>Property 2</td> <td>14.69</td> <td>10.61</td> <td>(4.08)</td> <td>13.18</td> <td>13.05</td> </tr> <tr> <td>Property 3</td> <td>8.53</td> <td>8.42</td> <td>(0.11)</td> <td>7.65</td> <td>7.57</td> </tr> <tr> <td></td> <td>29.69</td> <td>23.82</td> <td>(5.87)</td> <td>26.64</td> <td>26.36</td> </tr> </tbody> </table>	Property	Actual	31.03.2023 Actual		Outstanding Debt 31.03.2023	Outstanding Debt 31.03.2024	Value in Accounts	Cumulative Gain or (Loss)	Property 1	6.47	4.79	(1.68)	5.81	5.74	Property 2	14.69	10.61	(4.08)	13.18	13.05	Property 3	8.53	8.42	(0.11)	7.65	7.57		29.69	23.82	(5.87)	26.64	26.36
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5.1.3	<p>In addition to the properties purchased under PIF, the council holds an extensive historic property portfolio.</p> <p>Information relating to purchase price and any associated debt is not held, as this is not required by legislation. The fair value of all investment properties at the 31 March 2023 was £112.4M a decrease of £1.7M from the year before.</p> <p>The Valuation and Estates section are responsible for the ongoing management and monitoring of the portfolio (including PIF) and for 2022/23 net income for the total portfolio was £6.4M compared to £6.3M in 2021/22 a net return of 5.67% against the Fair Value (5.48% in 2021/22).</p>
5.2	Security
5.2.1	<p>In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than the amount of debt currently outstanding for the asset. As can be seen from the table above the fair value assessment of these properties at the 31 March 2023 is below the purchase price, this was partly due to cost associated with the purchase (£1.79M) which, in line with the MRP policy in place at the time, was charged to revenue in 2017/18. Debt repayments are on the annuity basis and debt will reduce by approximately £0.25M per annum.</p>
5.2.2	<p>Table 2 also shows that if the fair value for properties 1 and 2 continue to be below the outstanding debt on 31 March 2023 by £3.59M. As this is outside of the current policy, the future of these assets is being considered, in light of current government guidance, bearing in mind that a disposal may incur a financial loss to the council. The council will continue to closely monitor the situation, as part of Asset Development & Disposal Programme, to look for solutions to increase the value, opportunities for disposal and report any further concerns through the relevant committees.</p>
5.2.3	<p>The council is exploring mitigating actions to protect the capital invested in Property 2, whilst supporting economic growth in the City. These actions include plans to divide the existing unit into two smaller units, to achieve the following benefits:</p> <ul style="list-style-type: none"> • Creating more marketable units for future growth and support the changing needs of businesses, • Reducing exposure to one tenant's income on such a large unit, • Improving the combined covenant strength underpinning this asset, and • Increasing the capital value of the asset above the value of outstanding debt and purchase cost.

5.3	Risk Assessment
5.3.1	The council assesses the risk of loss before purchasing and whilst holding investment property and monitors both the fair value and the return on the assets to assess the benefits of either retaining or disposing of the assets.
5.3.2	Budgeted investment income allows for voids and maintenance costs, which are reviewed as part of budget monitoring on individual properties to ensure they continue to provide the correct level of risk management.
5.4	Liquidity
5.4.1	Compared with other investment types, property can be difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. Therefore, to assess liquidity, the Council monitors the income stream attached to property purchases, a much more liquid asset, comparing budgets to forecasts and actuals. Since purchasing the PIF properties actual income has and continues to be in line with the budgeted figure and there are no current indicators to suggest that the forecast future income is unachievable. Any change will be reported as part of the revenue financial monitoring process.
	<u>SECTION 6 - CAPACITY AND SKILLS</u>
6.1	Elected members and statutory officers
6.1.1	<p>CIPFA's Code of Practice requires the CFO to ensure that all Members tasked with Treasury Management (TM) responsibilities, including scrutiny of the TM function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Treasury training by our advisors, Arlingclose is offered to all members annually. This will be part of the training offered post the May 2024 election on financial matters.</p> <p>Further training will be provided where required, for example a change in leadership and the makeup of Governance committee or material change in the Treasury Strategy, to explain the reasons and ensure Members understand what they are being asked to approve.</p> <p>For officers, the Council adopts a continuous performance and development programme to ensure staff are regularly appraised and any training needs addressed. Relevant staff also attend regular training sessions, seminars and workshops which ensure their knowledge is up to date. Details of training received are maintained as part of the performance and development review process.</p>
6.2	Commercial deals
6.2.1	<p>Any future commercial investments will be subject to a detailed business case and need the relevant approvals. The Council has a robust process in place for property investment and therefore has a separate Property Investment Strategy.</p> <p>It sets out the scoring criteria each investment will be subject to, including financial checks on potential tenants to evidence their financial stability and risk level. An independent valuation will also be conducted to obtain a level of assurance that the</p>

	<p>price quoted, and the rent charged were in line with the expected market rate. Once all criteria are met final agreement is required by the S151 Officer, Head of Property, the Cabinet Member for Finance & Change, and the Leader of the Council.</p> <p>The Council has an experienced in-house estates and valuation team, who will manage the process and the day-to-day management of any investments. The use of external experts will be employed where specialist knowledge is required in the acquisition, disposal, or performance management of commercial property.</p>																					
	<u>SECTION 7 - INVESTMENT INDICATORS</u>																					
7.1	Background																					
7.1.1	The council has set the following quantitative indicators to allow elected members and the public to assess the council's total risk exposure because of its investment decisions.																					
7.2	Total Risk Exposure																					
7.2.1	This 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.																					
7.2.2	<p><i>Table 3: Total investment exposure £M</i></p> <table border="1"> <thead> <tr> <th></th> <th>31.03.2023 Actual</th> <th>31.03.2024 Forecast</th> <th>31.03.2025 Forecast</th> </tr> </thead> <tbody> <tr> <td>Treasury management investments</td> <td>54.6</td> <td>48.1</td> <td>38.1</td> </tr> <tr> <td>Service investments: Loans</td> <td>0.0</td> <td>0.0</td> <td>0.0</td> </tr> <tr> <td>Commercial Investments: PIF</td> <td>26.6</td> <td>26.4</td> <td>26.1</td> </tr> <tr> <td>TOTAL EXPOSURE</td> <td>81.2</td> <td>74.5</td> <td>64.2</td> </tr> </tbody> </table>		31.03.2023 Actual	31.03.2024 Forecast	31.03.2025 Forecast	Treasury management investments	54.6	48.1	38.1	Service investments: Loans	0.0	0.0	0.0	Commercial Investments: PIF	26.6	26.4	26.1	TOTAL EXPOSURE	81.2	74.5	64.2	
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Treasury management investments	54.6	48.1	38.1																			
Service investments: Loans	0.0	0.0	0.0																			
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TOTAL EXPOSURE	81.2	74.5	64.2																			
7.3	How Investments are Funded																					
7.3.1	Government guidance is that these indicators should include how investments are funded. Since the council does not normally associate assets with specific liabilities, this guidance is difficult to comply with. However, the following investments could be described as funded by borrowing. The remainder of the council's investments are funded by usable reserves and income received in advance of expenditure.																					
7.3.2	<p><i>Table 4: Investments funded by borrowing and loan to value ratio.</i></p> <table border="1"> <thead> <tr> <th><i>Investment funded by borrowing</i></th> <th>2022/23 Actual</th> <th>Loan to Value Ratio</th> <th>2023/24 Forecast</th> <th>Loan to Value Ratio</th> <th>2024/25 Forecast</th> <th>Loan to Value Ratio</th> </tr> <tr> <td></td> <td>£M</td> <td>%</td> <td>£M</td> <td>%</td> <td>£M</td> <td>%</td> </tr> </thead> <tbody> <tr> <td>Commercial Investments: Property (PIF)</td> <td>26.6</td> <td>112</td> <td>26.4</td> <td>111</td> <td>26.1</td> <td>109</td> </tr> </tbody> </table> <p>The maximum loan to value indicator is set at 100%. Table 4 demonstrates the loan outstanding exceeds the estimated fair value, in aggregate for the three properties. The policy adopted states if that position should arise i.e. the value is less than the outstanding sum borrowed, this should be reported to Council and hence this is highlighted. The council should then look to take steps to assess the viability of</p>	<i>Investment funded by borrowing</i>	2022/23 Actual	Loan to Value Ratio	2023/24 Forecast	Loan to Value Ratio	2024/25 Forecast	Loan to Value Ratio		£M	%	£M	%	£M	%	Commercial Investments: Property (PIF)	26.6	112	26.4	111	26.1	109
<i>Investment funded by borrowing</i>	2022/23 Actual	Loan to Value Ratio	2023/24 Forecast	Loan to Value Ratio	2024/25 Forecast	Loan to Value Ratio																
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Commercial Investments: Property (PIF)	26.6	112	26.4	111	26.1	109																

	holding the investment, but it is proposed that the position is monitored and a future decision tabled as part of the ADDP.			
7.4	Rate of return received			
7.4.1	This indicator shows the investment income received less the associated costs, including the cost of borrowing, as a proportion of the debt outstanding. 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 occur.			
7.4.2	<i>Table 5: Investment rate of return (net of all costs) %</i>			
	<i>Investment net rate of return</i>	<i>2022/23 Actual</i>	<i>2023/24 Forecast</i>	<i>2024/25 Forecast</i>
	<i>Property 1</i>	2.65	2.68	2.71
	<i>Property 2</i>	1.91	2.60	2.63
	<i>Property 3</i>	1.81	1.83	1.85
	<i>Total Average Rate of Return</i>	2.05	2.40	2.43