Annex 2.3(b)

Southampton City Council

INVESTMENT STRATEGY

2021/22 – 2024/25

Contents

	SECTION 1 – INTRODUCTION
1.1	**Background**
1.1.1	The Authority 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 meets the requirements of statutory investment guidance issued by the government in January 2018, and focuses on the second and third of these categories.
	SECTION 2 - TREASURY MANAGEMENT INVESTMENTS
2.1	**Background**
2.1.1	The Authority 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. The balance of treasury management investments is expected to be £40M at the end of 2021/22 financial year.
2.1.2	The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.
2.1.3	Full details of the Authority's policies and its plan for 2021/22 for treasury management investments are covered in a separate document, the treasury management strategy.
	SECTION 3 - SERVICE INVESTMENTS: LOANS
3.1	**Background**
3.1.1	The Council is able to lend money to its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth.
3.2	**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. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as in Table 1.

3.2.2 **Table 1 – Loans for service purposes £M**

Category of Borrower	31.03.2020 Net showing in accounts	2021/22 Approved Limit
Subsidiaries	-	2.00
Suppliers	-	2.00
Other Public Sector Bodies	-	20.00
Charities	-	0.50

3.2.3 Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts are shown net of this loss allowance. However, the Authority 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**

3.3.1 The Council does not currently have any material loans but loans to subsidiaries may be considered, 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 will be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;
- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;
- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;
- 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.

SECTION 4 - SERVICE INVESTMENTS: SHARES

4.1 **Background**

4.1.1 The Council is able to invest in the shares of its subsidiaries, its suppliers, local businesses, local charities, housing associations, local 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 purchase and would establish appropriate Prudential Indicators.

SECTION 5 - COMMERCIAL INVESTMENTS: PROPERTY

5.1 **Background**

5.1.1 The Council is able to invest in local, regional and UK commercial and residential property with the intention of making a profit that will 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 being used to fund council services, known as the Property investment fund (PIF). To date the authority has purchased 3 properties, details are shown in table 2 below.

These properties are expected to generate £1.8M income in 2020/21 a return of 1.97% against the amount invested.

5.1.2 *Table 2: Property Investment Fund £M*

Property	Actual	31.03.2020 Actual		31.03.2021 Expected			Outstanding Debt 31.03.2021
	Purchase Cost	Value in Accounts	Cumulative Gain or (Loss)	Value in Accounts	Cumulative Gain or (Loss)	Change In Year	
Property 1	6.47	6.30	(0.17)	5.21	(1.26)	(1.09)	5.92
Property 2	14.69	10.80	(3.89)	10.33	(4.36)	(0.47)	13.45
Property 3	8.53	8.39	(0.14)	8.73	0.20	0.34	7.80
	29.69	**25.49**	**(4.20)**	**24.27**	**(5.42)**	**(1.22)**	**27.17**

5.1.3 In addition to the properties purchased under PIF, the council holds an extensive historic property portfolio.

Information relating to purchase price and any associated debt is not held, as this is not required by local authority legislation. The fair value of these properties at the 31 March 2020 was £92.66M a decrease of £15.5M from the year before. The year-end valuation of investment property was not significantly impacted by COVID-19, however there was a £15M year-on-year reduction in investment property valuations due to the Valuer making a slightly more prudent assessment of investment properties as at 31 March 2020. However, it is anticipated that there will be a significant COVID-19 impact on the 31 March 2021 values which is yet to be quantified.

The Valuation and Estates section are responsible for the ongoing management and monitoring of the portfolio (including PIF) and for 2019/20 net income for the total portfolio was £8.4M compared to £8.03M in 2018/19.

5.1.4 In November 2019 Council approved the addition of £200M to the capital programme to explore the opportunities available for further property investment, with expected purchases to start from 2020/21. However, following changes to the rules for lending from the Public Works Board to finance such projects this has been removed from the capital programmed.

5.2	**Security**
5.2.1	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 2021 is expected to be 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 now being made on the annuity basis and debt will reduce by approximately £0.25M per annum.
5.2.2	Table 2 also shows that the values of Properties 1 and 2 are expected to drop further in 2020/21 due to the further recent downturn in the retail sector largely due to COVID-19. This means that the fair value will likely fall below the outstanding debt by £3.83M. As this is outside of the current policy, consideration will need to be given to the future of these assets, bearing in mind that a disposal would be likely to incur a large financial loss to the Council. However, whilst the properties are still providing a positive income yield, it makes no financial sense to dispose of the properties in the current economic climate, the Council will continue to closely monitor the situation and report any further concerns through the relevant committees.
5.3	**Risk Assessment**
5.3.1	The council assesses the risk of loss before purchasing 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 is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. Therefore, in order 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 will not be achieved. If there is any change this would be reported as part of the revenue financial monitoring process.
	SECTION 6 - CAPACITY AND SKILLS
6.1	**Elected members and statutory officers**
6.1.1	CIPFA's Code of Practice requires the CFO to ensure that all Members tasked with TM responsibilities, including scrutiny of the TM function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

	Treasury training is offered to all members annually, which is undertaken by our advisors, Arlingclose, this was last undertaken on 11th January 2021. Further training is also provided if the need arises, for example there was a change in leadership and the makeup of Governance committee changed during 2018, so as part of Members induction Arlingclose provided an introduction to treasury training session. We would also arrange additional training if there was to be a material change in the Treasury Strategy, explaining the reasoning behind it, so that Members understand what they are being asked to approve. 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 process.
6.2	**Commercial deals**
6.2.1	The Property Investment Fund, originally agreed at full Council in November 2019, has been withdrawn from the capital programme following rule changes from Government that prevent any further investment primarily for yield. Capital spending plans will need to be submitted in advance to Government, and the S151 officer provide assurance that the council will not be undertaking investment of assets primarily for yield gain. Existing investments held by the authority will continue to be carefully monitored and reported on. 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.
	SECTION 7 - INVESTMENT INDICATORS
7.1	**Background**
7.1.1	The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.
7.2	**Total Risk Exposure**
7.2.1	This indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.
7.2.2	*Table 3:Total investment exposure £M*

Total Investment Exposure	***31.03.2020 Actual***	***31.03.2021 Forecast***	***31.03.2022 Forecast***
Treasury management investments	***61.2***	***40.0***	***40.0***
Service investments: Loans	***0.0***	***0.0***	***0.0***
Commercial Investments: PIF	***27.4***	***27.2***	***26.9***
TOTAL EXPOSURE	***88.6***	***67.2***	***66.9***

7.3	**How Investments are Funded**
7.3.1	Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.
7.3.2	*Table 4: Investments funded by borrowing and loan to value ratio*

Investment funded by borrowing	***2019/20 Forecast***	***2019/20 Actual***	***Loan to Value Ratio***	***2020/21 Forecast***	***Loan to Value Ratio***	***2021/22 Forecast***
	£M	***£M***	***%***	***£M***	***%***	***£M***
Commercial Investments: Property	***27.4***	***27.4***	***108***	***27.2***	***112***	***26.9***
Service investments: Loans	***0.0***	***0.0***		***0.0***		***0.0***

The maximum loan to value indicator is set at 100% if the fair value of the asset was to fall below the outstanding loan value then this would be reported to Council and the authority would look to take steps to assess the viability of holding the investment.

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 incurred.
7.4.2	*Table 5: Investment rate of return (net of all costs)*

Investment net rate of return	***2019/20 Actual***	***2020/21 Forecast***	***2021/22 Forecast***
	%	***%***	***%***
Property 1	***2.27***	***2.29***	***2.04***
Property 2	***2.16***	***2.18***	***1.98***
Property 3	***1.37***	***1.38***	***1.30***
Total Average Rate of Return	***1.95***	***1.97***	***1.80***