

# North Norfolk District Council Investment Strategy 2021/22

|                             |   |
|-----------------------------|---|
| Summary:                    | This report sets out details of the Council's investment activities and presents a strategy for the prudent investment of the Council's resources.                                |
| Options Considered:         | Alternative investment and debt options are continuously appraised by the Council's treasury advisors, Arlingclose and all appropriate options are included within this Strategy. |
| Conclusions:                | The preparation of this Strategy is necessary to comply with the guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG).                            |
| Recommendations:            | That the Council be asked to RESOLVE that The Investment Strategy is approved.  |
| Reasons for Recommendation: | The Strategy provides the Council with a flexible investment strategy enabling it to respond to changing market conditions.   |

|  |                       |
|--|-----------------------|
| Cabinet Member(s)<br>Cllr E Seward                                   | Ward(s) affected: All |
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## Introduction

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 guidance issued by the government in January 2018, and focuses on the second and third of these categories.

The Corporate Plan sets out what the Council intends to do between 2019 and 2023. It focuses on six priorities which will influence how we move forward:

- Local Homes for Local Need

- Boosting Business Sustainability and Growth
- Customer Focus
- Climate, Coast and the Environment
- Financial Sustainability and Growth
- Quality of Life

The Council's investments can be used to help deliver these priorities.

### **Treasury Management Investments**

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 fluctuate between £34.8m and £46.2m during the 2021/22 financial year.

**Contribution:** The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

**Further details:** 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.

### **Service Investments: Loans**

**Contribution:** The Council may lend money to its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth. The Council is currently lending to Broadland Housing Association at a commercial rate of interest to support the provision of affordable housing within North Norfolk. The income forms part of the Council's interest budget for the year and supports the delivery of Council services. In the 2016/17 financial year, the Council received a grant from Central Government to support community housing. It is the intention that part of this fund will form a loans fund to allow community initiative around housing to be supported and the income to be recycled. The rates of interest are likely to be below commercial rates and so represent soft loans. To date, no loans of this nature have been made from the fund.

**Security:** 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 follows:

*Table 1: Loans for service purposes in £ millions*

| Category of borrower | 31.3.2020 actual |                |                        | 2021/22        |
|----------------------|------------------|----------------|------------------------|----------------|
|                      | Balance owing    | Loss allowance | Net figure in accounts | Approved Limit |
| Housing associations | 2.896            | 0.003          | 2.893                  | £10m           |
| <b>TOTAL</b>         | <b>2.896</b>     | <b>0.003</b>   | <b>2.893</b>           | <b>£10m</b>    |

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.

**Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding service loans by using advisors and quality financial press to assesses the market that the investment will be competing in, the nature and level of competition, along with expectations on how the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements. The quality of advice is moderated by frequently subjecting the contracts to tender. Risk assessments include reference to credit ratings, but are not the sole indicator of risk used. Credit ratings are actively monitored by advisors and changes are relayed to the Authority using an alert system. Other information, such as credit default swaps, are used to assess risk.

### **Service Investments: Shares**

**Contribution:** The Council may invest in the shares of its suppliers, and local businesses to support local public services and stimulate local economic growth. At the present time, the Council does not hold these type of investments.

**Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

*Table 2: Shares held for service purposes in £ millions*

|  | 31.3.2020 actual | 2021/22 |
|--|------------------|---------|
|  |                  |         |

| Category of company | Amounts invested | Gains or losses | Value in accounts | Approved Limit |
|---------------------|------------------|-----------------|-------------------|----------------|
| Subsidiaries        | Nil              | Nil             | Nil               | £5m            |
| Suppliers           | Nil              | Nil             | Nil               | £5m            |
| Local businesses    | Nil              | Nil             | Nil               | £5m            |
| <b>TOTAL</b>        | <b>Nil</b>       | <b>Nil</b>      | <b>Nil</b>        | <b>£15m</b>    |

**Risk assessment:** The approach is very similar to that of the service loans, the Authority assesses the risk of loss before entering into and whilst holding shares by using advisors and quality financial press to assesses the market that the investment will be competing in, the nature and level of competition, along with expectations on how the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements. The quality of advice is moderated by frequently subjecting the contracts to tender. Risk assessments include reference to credit ratings, but are not the sole indicator of risk used. Credit ratings are actively monitored by advisors and changes are relayed to the Authority using an alert system. Other information, such as credit default swaps, are used to assess risk.

**Liquidity:** The Council actively monitors the availability of cash, using established cash flow procedures to inform decisions around the maximum that may be committed over any given time horizon.

**Non-specified Investments:** Shares are the only investment type that the Authority 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 Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

### **Commercial Investments: Property**

**Contribution:** The Council invests directly in local commercial property with the intention of making a profit that will be spent on local public services. The Council currently holds two main investment properties. The depot building at Grove Lane, which is rented out to a private sector developer and Fair Meadow House, a property used for short term holiday let accommodation. Fair Meadow House provides rental income for the Council, but also supports the tourist offer within North Norfolk.

*Table 3: Property held for investment purposes in £ millions*

| Property | Actual | 31.3.2020 actual | 31.3.2021 expected |
|----------|--------|------------------|--------------------|
|----------|--------|------------------|--------------------|

|                   | <b>Purchase cost</b> | <b>Gains or (losses)</b> | <b>Value in accounts</b> | <b>Gains or (losses)</b> | <b>Value in accounts</b> |
|-------------------|----------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Grove Lane Depot  |                      | 0.014                    | 0.391                    | -                        | 0.391                    |
| Fair Meadow House | 0.582                | (0.076)                  | 0.441                    | -                        | 0.441                    |
| <b>TOTAL</b>      | <b>0.582</b>         | <b>(0.062)</b>           | <b>0.832</b>             | <b>-</b>                 | <b>0.832</b>             |

**Security:** In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2020/21 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

**Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding property investments by using advisors and quality financial/property press to assesses the market that the investment will be competing in, the nature and level of competition, along with expectations on how the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements. We have qualified staff that will consider the local market and also have a number of external advisors and agents who we seek advice from where appropriate. This also extends to national advice although the Council's current strategy is to invest within the local area. Risk assessments include reference to credit ratings, but are not the sole indicator of risk used. Credit ratings are actively monitored by advisors and changes are relayed to the Authority using an alert system.

**Liquidity:** 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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority maintains a balanced portfolio of investments, with short term investments allowing for faster liquidation should it be required.

### **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 Authority and are included here for completeness.

The Authority has not currently contractually committed to make any loans or guaranteed any loans and has no current plans to do this.

### **Proportionality**

The Authority plans to become dependent on profit generating investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Authority is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Authority will in the short term use available reserve balances to meet the shortfall, while a full review of service provision is undertaken.

*Table 4: Proportionality of Investments*

|                           | <b>2019/20<br/>Actual</b> | <b>2020/21<br/>Forecast</b> | <b>2021/22<br/>Budget</b> | <b>2022/23<br/>Budget</b> | <b>2023/24<br/>Budget</b> |
|---------------------------|---------------------------|-----------------------------|---------------------------|---------------------------|---------------------------|
| Gross service expenditure | 67.249                    | 61.260                      | 61.473                    | 62.139                    | 62.293                    |
| Investment income         | 1.295                     | 1.372                       | 1.015                     | 1.120                     | 1.120                     |
| Proportion                | 1.93%                     | 2.24%                       | 1.65%                     | 1.80%                     | 1.80%                     |

### **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 Authority has chosen to follow this guidance.

### **Capacity, Skills and Culture**

**Elected members and statutory officers:** Members and Statutory officers attend regular training on Treasury Investment principles and have access to informed officers who are required to keep up with CPD requirements by their professional bodies. The individual business cases allow Members to assess individual assessments in the context of the strategic objectives and risk profile of the local authority; and enable them to understand how these decisions have changed the overall risk exposure of the local authority.

**Commercial deals:** The Council's Asset Management Plan is closely linked to the Corporate Plan and the Capital Strategy which contains the Prudential Indicators. We have qualified staff and support from external advisors to support with property transactions and negotiations. The Estates team are aware of the various strategy documents and the requirements contained therein, this also covers the prudential framework and the regulatory regime in which the Council operates and is

supplemented by external training and Continuing Professional Development where appropriate.

**Corporate governance:** Budgets for investment purchases are agreed by Full Council in line with corporate objectives. A £2m property investment fund was agreed in February 2018, after being subject to scrutiny by Members. Business Cases will either come forward to Cabinet (if not time sensitive) or an Asset Management Working Party, which is a cross-party subsection of the Overview and Scrutiny Committee. Treasury Investments are subject to governance checks through the agreement of the Treasury Strategy for the year, as well as half-yearly updates.

### **Investment Indicators**

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.

**Total risk exposure:** The first 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.

*Table 5: Total investment exposure in £millions*

| <b>Total investment exposure</b> | <b>31.03.2020<br/>Actual</b> | <b>31.03.2021<br/>Forecast</b> | <b>31.03.2022<br/>Forecast</b> |
|----------------------------------|------------------------------|--------------------------------|--------------------------------|
| Treasury management investment   | 43.888                       | 68.469                         | 36.894                         |
| Service investments: Loans       | 2.827                        | 2.692                          | 2.423                          |
| Commercial investments: Property | 0.832                        | 0.832                          | 0.832                          |
| <b>TOTAL INVESTMENTS</b>         | <b>47.547</b>                | <b>71.993</b>                  | <b>40.149</b>                  |
| Commitments to lend              | 0.00                         | 0.00                           | 0.00                           |
| Guarantees issued on loans       | 0.00                         | 0.00                           | 0.00                           |
| <b>TOTAL EXPOSURE</b>            | <b>48.768</b>                | <b>45.712</b>                  | <b>43.581</b>                  |

**How investments are funded:** 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.

*Table 6: Investments funded by borrowing in £millions*

| <b>Investments funded by borrowing</b> | <b>31.03.2020<br/>Actual</b> | <b>31.03.2021<br/>Forecast</b> | <b>31.03.2022<br/>Forecast</b> |
|--|------------------------------|--------------------------------|--------------------------------|
| Treasury management investments        | Nil                          | Nil                            | Nil                            |
| Service investments: Loans             | Nil                          | Nil                            | Nil                            |
| Commercial investments: Property       | Nil                          | Nil                            | Nil                            |
| <b>TOTAL FUNDED BY BORROWING</b>       | Nil                          | Nil                            | Nil                            |

**Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. 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.

*Table 7: Investment rate of return (net of all costs)*

| <b>Investments net rate of return</b> | <b>2019/20<br/>Actual</b> | <b>2020/21<br/>Forecast</b> | <b>2021/22<br/>Forecast</b> |
|---------------------------------------|---------------------------|-----------------------------|-----------------------------|
| Treasury management investments       | 2.97%                     | 1.97%                       | 2.62%                       |
| Service investments: Loans            | 3.8%                      | 3.8%                        | 3.8%                        |
| Commercial investments: Property      | 3.72%                     | 2.82%                       | 5.12%                       |

*Table 8: Other investment indicators*

| <b>Indicator</b>                                       | <b>2019/20<br/>Actual</b> | <b>2020/21<br/>Forecast</b> | <b>2021/22<br/>Forecast</b> |
|--|---------------------------|-----------------------------|-----------------------------|
| Debt to net service expenditure ratio                  | Nil                       | Nil                         | Nil                         |
| Net Commercial income to net service expenditure ratio | 0.16%                     | 0.13%                       | 0.24%                       |