Commercial Investment Strategy **Appendix 6**

This strategy is produced in line with statutory government guidance on Local Government Investments issued under the Local Government Act 2003. It sets out how commercial investments are managed, other than those covered by the Treasury Management Strategy (Section 2.4, Appendix 5), specifically covers investments in shares, loans provided by the Council and commercial property holdings.

The key areas covered in the strategy are:

- ***Transparency and democratic accountability***;
- ***Contribution of investments*** to achieving the objectives of the Council;
- Consideration of the balance between the ***security, liquidity and yield*** of investments
- The need to assess ***security and the risk of loss*** when making or holding an investment;
- The need to determine the ***liquidity*** of investments, including the determination of the maximum periods for those investments, and how funds can be accessed when needed;
- The ***proportionality*** of the investments given the overall size of the authority;
- The authorities approach ***borrowing purely in order to profit*** from an investment or "borrowing in advance of need" as it is referred to in the guidance;
- The need to ensure that members and statutory officers have the appropriate ***capacity, skills and culture*** to make informed decisions in respect of investments;
- The use of technical ***indicators*** to assess risk and return.

The Council's Commercial Investments

The Council holds the following commercial investments:

- **Shares in companies,** with the main holdings being in 3 companies: the Coventry & Solihull Waste Disposal Company, Birmingham Airport and Coombe Abbey Park Limited. In total, shares held by the Council had a value of £95m as at 31/03/2018. The bulk of this represents increases in the value of the shares rather than cash funds invested. An estimated £20.8m of the £95m represents capital funds invested over time. Share dividend income totalled £7.8m in 2017/18. In addition, the purchase of shares for £10m in Friargate Development in 2018/19 will add to the Council's total share portfolio.

  One of the risks of investing in shares is that they fall in value, meaning that the initial investment may not be recovered. In order to limit this risk, an upper limit of £50m (Indicator 4) is set on the sum invested in shares, excluding any change in the value of shares already held.
- **Commercial property** holdings across Coventry, including offices, shops and retail units assembled over many years. In total, commercial property held by the Council had a value of £174.3m as at 31/3/2018 with net rental income totalled £11.9m in 2017/18. The fair value of commercial property is assessed annually, with the top 50 commercial property assets plus 33% of the remainder of the portfolio being reviewed. In terms of overall value c85% of the total value of the portfolio is reviewed annually.

  The statutory guidance on investments requires authorities to consider whether the fair value of commercial property assets provides security for the capital invested; essentially whether the value is greater than the cost. Of the total value of commercial property of

£174.3m approximately £100m represents increases in value over the past 20 years, indicating that the authority does have security in the terms set out in the guidance.

- **Loans provided** by the Council ("service loans"), totalling £9.5m as at 31/3/18. The main loans are: Coombe Abbey Park Ltd (£4.8m); local residents under the Kickstart scheme (£1.9m) and Culture Coventry Trust (£0.8m). In addition, during 2018/19 further loans totalling £10.3m have been approved to be provided over the coming years including: Friargate (£5m); Allan Higgs Centre (£1.2m), Coombe (£1.95m). This would increase the Council's total loan exposure to over £16m at the end of 2018/19.

  The main risk when making service loans is that the borrower will be unable to repay the principal lent and interest due. In order to limit this risk, and ensure that total exposure to such loans remains proportionate to the size of the authority an upper limit of £32m (Indicator 5) is set on the sum invested , excluding any change in the value of service loans already held.

Transparency and Democratic Accountability

In line with the Investment Guidance, the Strategy will be prepared annually and will be approved by Council, with any material changes being presented to Council for approval. As part of the wider Budget Report incorporating the related treasury management and capital strategies, this strategy will be openly available on the Council's website. In addition, there is extensive reporting in respect of commercial investments within the Statement of Accounts. The Council's constitution, through the application of approval thresholds, ensures that investment schemes are considered for approval at the appropriate level, taking into account materiality.

Contribution to the Objectives of the Council

The Council invests in commercial assets to support the wider provision of local and regional public services, including to stimulate economic growth and develop employment opportunities. Investments made within the city or region have a service dimension that those made outside of the region are unlikely to have. Under this Strategy the Council's investment are primarily focused on the city and the immediate region supporting service objectives.

In addition, as commercial investments the Council seeks a financial return through income generated from interest on loans, dividends and rents, as well as through disposal proceeds when assets are sold.

Security, Liquidity and Yield

Strategic plans including financial plans embodied within the Medium Term Financial Strategy, as well as Business Cases for individual investments, will include the consideration of the security, yield and liquidity of the investments, together with the associated risk management arrangements and the proportionality of the investment within the Council's wider financial standing.

Risk Assessment

For each category of investment the Council assesses the risk of loss before making commercial investments and whilst holding such investments as set out below:

Investment Type	Approach to Risk Assessment
Shares	• Reviewing the underlying Business Plan of the organisation, including the assumptions about the market in which the company operates. In understanding the market in which the organisation operates external advice will often be needed; • Assessing the financial strength of the organisations through the use of independent credit assessments and ratings (where available) , and the review of published accounts and financial reports; • Considering governance issues, including potentially those set out in audit or external advice reports of the organisation; • Considering risk management including the identification of risk issues through an organisation's statement of accounts and internal risk registers where appropriate. Once shares have been acquired, the Council manages its interest as a shareholder through a number of routes including: Board membership/appointment; monitoring of financial and other reporting information; operation of shareholder panels.
Commercial Property	• Undertaking a detailed financial and operational due diligence assessment, prior to acquiring commercial property assets, identifying the relevant risks (e.g. financial, operational). The assessment includes condition, mechanical and electrical surveys, a review of the occupational leases, title investigations etc to ensure that the Council has full knowledge of the asset to be acquired. The financial assessment includes consideration of full life costs, including capital investment requirements, the level and security of income and potential alternative use returns; • Using the Council's extensive local market knowledge developed through its longstanding ownership and management of commercial property within the city; • Credit rating assessments (e.g. through Dun and Bradstreet) are carried out on the tenants of the properties that are being acquired in order to determine the strength of the covenant and security of forecast income. Once acquired properties are then managed by the Council's Commercial Property Management Team, whilst financial performance, including yields etc is monitored through the Council's developing property performance review arrangements.
Service Loans	• Reviewing the underlying business case for the loan, including where appropriate project or wider organisation business plans. This will include consideration of relevant market information; • Seeking security through asset specific or other legal charges;

	• Assessing the financial strength of the organisation through the use of independent credit assessments and ratings (where available) and the review of published accounts and financial reports; • Including appropriate financial covenants in loan agreements ; • Managing the potential budgetary impact of any risk of loss, for example by the “up front” resourcing of any capital spend through the use of capital receipts rather than borrowing. Once provided, service loans are managed in order to minimise the chance and mitigate the impact of any default. Loans are administered to ensure the timely payment of interest and principal, and long term security of the Council’s interest. Monitoring information is provided by borrowers, at a level appropriate to the individual loan, including for example, statutory financial and management reporting information. Loans are assessed under IFRS9 for impairment, using the “expected credit loss model”.

As appropriate, the local authority will use external advisors to assess the market, legal, financial and technical advice in respect of all investment types. In order to monitor and maintain the quality of the advice the authority will:

- identify appropriate providers, where appropriate procuring through a competitive process;
- ensure clarity about: its needs, the scope and specification of works, resources required, outputs and timescales;
- ensure oversight of the contract, strong communication and post contract review.

Liquidity of Investments

Where resources need to be generated this requirement is managed through the Council’s wider processes, including the Medium Term Financial Strategy (MTFS). This can, for example, take the form of identifying savings within spending programmes or the use of reserves, although ultimately it could entail the sale of assets. Where asset sales are required, the MTFS based corporate approach ensures that the need to realise resources can be focused across the Council’s entire asset base rather than being restricted to specific assets. This strategic approach helps maximise flexibility and the potential to realise value from asset disposals, in a timely manner.

As ordinary shares have no defined maturity or repayment period, liquidity will depend on the ability to sell the shares at any point in time and therefore the market at the time of sale. Consequently no maximum investment or maturity periods are set. Similarly, the liquidity of a particular property purchased as an investment will depend on the market at the point of sale.

The terms of service loans provided by the Council will include provision for the repayment of the loan, thereby determining liquidity. Loan durations will vary and will in part be determined by the purpose of the particular loan, and the underlying spend being financed, with for example a loan to finance the construction of a building being repayable over a longer maximum term than a loan for the purchase of equipment.

Proportionality

The Council generated total commercial income of £20.5m in 2017/18 (loan interest £0.8m, share dividends £7.8m and net property rents £11.9m). Whilst a significant cash sum contributing to the balancing of the Council's budget, this figure represents 3% of the Council's net service expenditure and contrasts to other income sources such as fees and charges which, at approximately £63m (2018/19), represents 10% of net service expenditure. In expanding the generation of commercial income the Council will seek to ensure that investments are diversified across different commercial asset types in order to manage risk. However, it is inevitable that Council investment will be focused in local areas in a way that is unlikely to be the case for national investors, reflecting the service dimension of investment decisions.

Borrowing to Fund Commercial Investment Purely for Profit

In line with good practice, the authority will only borrow to resource investment in commercial assets where the business case is strong, where it is prudent to do so in the long term, and on the basis that the risk is proportionate to the authority's wider financial structure. Where commercial investments are made within the city or region, such investments will help contribute to the authority's service objectives, for example in promoting economic regeneration and growth, or developing employment opportunities.

In order to proactively manage risk the authority will make Minimum Revenue Provision on such investments where they are resourced from borrowing, rather than relying on the value within the asset to cover the long term debt impact of the investment.

Capacity, Skills and Culture

The City Council ensures that it has the capacity, skills and culture to effectively manage its commercial investments and the associated risk in a number of way, including, by ensuring that:

- Qualified and experienced internal staffing resources are available in key areas including property management, finance and legal services. External advisors are employed where specialist advice is unavailable internally e.g. in assessing business value in making significant share acquisitions;
- Investment proposals are subject to robust appraisal and business cases assessments covering key areas e.g. security, yield and liquidity over the long term or full life of the investment, beyond the duration of the Council's Medium Term Financial Strategy. The assessment of the business case is included at the appropriate level of detail in reports seeking member approval to the investment;
- The Council's constitution sets out clear and strong governance structures for the approval of financial transactions, including the thresholds for approval by Cabinet Member, Cabinet or Council etc. These arrangements are fundamental in ensuring that investment proposals are considered in the context of the Council's strategic objectives;
- The role of the Section 151 Officer is key in providing input into the consideration of investment proposals, from the initial detailed business case assessment through to approval by the relevant Cabinet Member, by Cabinet or Council. Where necessary, for example due to potential conflicts of interest, the role of Section 151 is undertaken by another appropriately qualified and experienced officer;
- The development of this Commercial Investment Strategy, and associated indicators, will help embed the proactive management of investments and associated risks into the

Council's day to day activities. At a senior officer level, the Capital Investment Group established in 2018, will be central to this;

- Strong in-year financial monitoring, including to Cabinet and Council continues as a cornerstone of the management of the Council's finances and associated risks. The development of commercial property portfolio financial reporting continues as a management tool, highlighting, for example, financial yield relative to asset value.

Commercial Investment Indicators

A number of indicators are produced to support the strategy. The prime focus of the indicators is the management of risk and the demonstration of proportionality of the investments in the context of the Council's overall finance and asset base. In addition to the indicators set out, a number of others are used to support the day to day management of the investment portfolio. For example, extensive use is made of performance indicators in managing the Council's Investment Property portfolio.

Where data is not available, for example because the recommended indicator is inconsistent with the way that local authorities generally record data and manage their finances, then alternative indices are used instead, for the same purpose. The commercial investment indicators are summarised below and set out in detail in Appendix 7b:

- **Investment Category Value (Indicator 1)**. This indicator is designed to demonstrate risk exposure by indicating the value of commercial assets compared to all city council assets. Commercial assets are forecast to be 24% of total city council assets in 2019/20.

- **Debt Funding per Investment Category (Indicator 2)**. Although historic borrowing is not identifiable to specific investments, the Council's underlying borrowing requirement, in the form of the Capital Financing Requirement, was 31% of total council assets by current value (as at 31/03/2018), indicating that assets provide 3 times cover for the underlying borrowing requirement.

- **Rate of Return per Investment Category (Indicator 3)**. Although rate of return is not calculated net of capital financing costs for the reasons referred to above (see Indicator 2), an alternative, based on gross income is used. In addition, the return is stated as a % of current value rather than historic cost as detailed data is not held on the latter. The total rate of return on commercial investments is 7.3%.

- **Service Loans (Indicator 4) and Shares (Indicator 5).** Unlike other commercial investment indicators these two indicators represent limits above which the city council should not invest. These can only be varied with the approval of Council and are referred to in the earlier section "The Council's Commercial Investments" in which the investment types are covered in greater detail.

- **Debt: Net Service Expenditure/NSE (Indicator 6) and Commercial Income: Net Service Expenditure/NSE (Indicator 7).** These indicators demonstrate the proportionality, both of the level of the Council's debt and of its reliance on commercial income. Debt represents 59% of NSE and commercial income 3.4%.

The use of indicators will be reviewed through the first year of the strategy and refined to maximise the usefulness in managing commercial investments.