Coventry City Council

Briefing note

To: Finance and Corporate Services Scrutiny Board 1

Date: 21st September 2023

Subject: Commercial Investments and Income Generation

1 Purpose of the Note

1.1 This note sets out the Council's approach to making commercial investment decisions, the statutory framework that the Council needs to work within and how decisions are made, including the policy basis. The note examines the content of the Council's Commercial Investment Strategy including annual limits and details about the overall commercial portfolio and performance.

1.2 The 2022/23 Revenue and Capital Outturn Report is included as Appendix 2 to provide an understanding of the Council's current financial challenges and financial context for its overall strategy. The Strategic Energy Partner Report (scheduled for Cabinet on 29 August) is similarly attached at Appendix 3, providing a current example of the Council's approach to commercial investment. Further papers will be published in relation to the Council's Shareholder Committee with details of some of the Council' shareholdings after this Scrutiny Board's publication date, but prior to its meeting, and will be made available to Committee members separately. (The papers will be published on Monday 18 September on the Council's website: https://edemocracy.coventry.gov.uk/ieListDocuments.aspx?CId=773&MId=13020&Ver=4)

2 Recommendations

2.1 The Finance and Corporate Services Scrutiny Board (1) is recommended to:

1) Note the content of the report.

2) Make any recommendations for the relevant Cabinet Member.

3 Background and Information

Policy and Regulatory Background

3.1 The One Coventry Plan provides the broad policy basis for the Council's service delivery including its approach to commercial activity. The Plan's three delivery priorities are: increasing the economic prosperity of the city and region; improving outcomes and tackling inequalities within our communities and; tackling the causes and consequences of climate change. Fundamental to this note is that one of the two enabling priorities identified within the Plan is the continued financial sustainability of the Council.

3.2 Like many local authorities across the country the Council's medium term financial position forecasts revenue funding gaps. The 2023/24 Budget Report (February 2023) identified gaps of £20m and £30m for 2024/25 and 2025/26 whilst the most recent monitoring report to Cabinet (August 2023) has highlighted further budgetary pressure which indicates a worsening position both for the Council and the wider sector.

3.3 The ongoing need to balance budgets has, for many years, led councils to adopt commercial approaches to improve their financial positions and deliver better services. This activity can take many forms including the following, listed notionally in the order of perceived risk:

- charging for local services to citizens and service users,
- providing and charging for traded services as an extension to in-house provision,
- acting as a landlord for a commercial property portfolio,
- providing loan finance to local organisations,
- establishing/acquiring external companies to complement the delivery of strategic objectives and,
- commercialisation through more speculative capital investment outside of municipal boundaries or on a disproportionately large scale to deliver financial returns.

The Council undertakes all these activities to a greater or lesser degree with the exception of the final one. Charges to local citizens and service users and for traded services is not covered in detail in this report but a list of income categories in relation to these activities is included at Appendix 1.

3.4 Recent years have witnessed increased activity of a more speculative nature (most but not all related to the final bullet above) and a small but not insignificant number of financial failures as a result. Councils such as Thurrock, Slough and Woking amongst others have suffered very large financial losses which have led to the issuing of a Section 114 Notice. A S114 Notice is an indication that the expenditure of an authority is likely to exceed the resources for the year and means that no new expenditure is permitted, with the exception of that funding statutory services.

3.5 There is already a significant regulatory and advisory framework around council financial activity in areas such as borrowing (the Prudential Code), treasury management and investments, Minimum Revenue Provision, the Public Works Loans Board (PWLB) and capital strategies. In response to the sector failures referred to above, the Government has moved to increase intervention and regulation change aimed at preventing future such occurrences. This has led to the introduction of commercial investment strategies, revisions to the Prudential Code (requiring a proportionate to risk) and new rules for borrowing from the PWLB (preventing investing primarily for yield).

<u>The Council's Approach</u>

3.6 Whilst it is difficult to definitively benchmark it is likely that the Council sits somewhere "within the pack" in relation to the income it generates from charging for services and traded services. These are activities that occur mostly as a result of 'business as usual' activity.

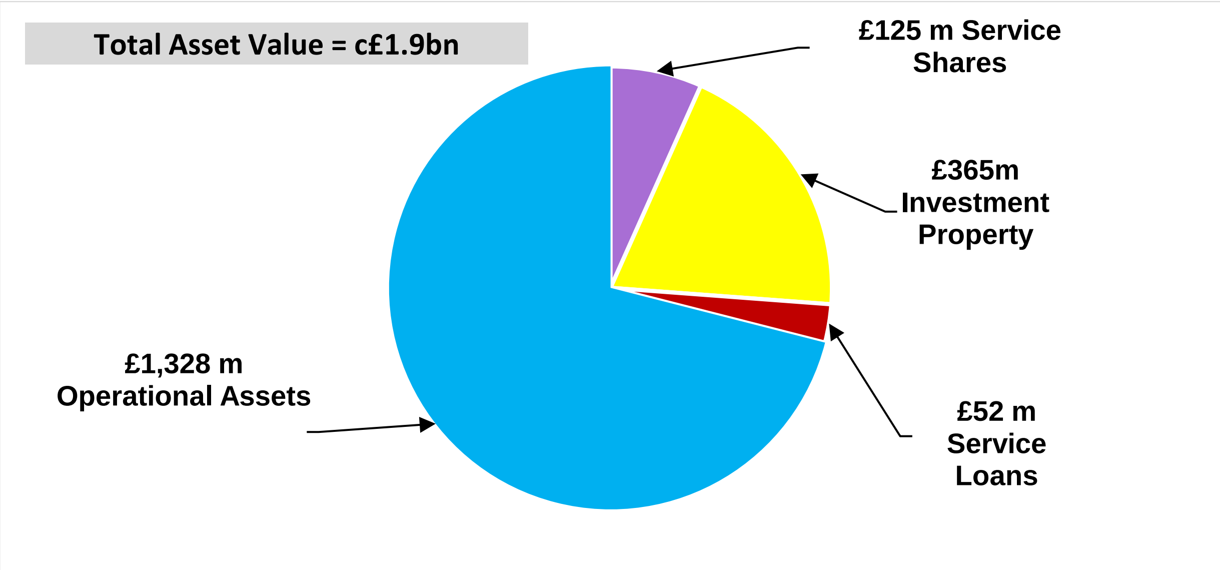
3.7 Data collected previously suggested that Coventry holds a relatively large property portfolio compared with other councils whilst the Council has been increasingly active in terms of providing external loan finance in recent years and has a significant number of company shareholdings compared with many similar authorities. It is these types of activity that have a higher risk profile and have prompted the interest of regulators in recent years.

3.8 Like other councils, the Council's approach has been informed by the need for it to generate additional income streams to support its budgetary position. However, at a local level, each commercial intervention made by the Council has had strong policy, service and/or risk mitigation justifications. These activites have a direct impact on the Council's balance sheet and are therefore measured periodically. This measurement is helpful in establishing whether the activity is proportionate in comparison to the Council's overall asset base and the scale of overall risk of each activity type. This is explored in the following section.

The Council's Commercial Activity

3.9 The following chart shows the latest estimate of the key categories of long-term assets on the Council's balance sheet. 71% of the value is held in the form of operational assets, essentially the land, buildings and infrastructure owned by the Council from which services are delivered. A further 19% is represented by investment property which generates an on-going commercial rent and whose valuation is essentially driven by that rent. The remaining 10% is held in the form of long-term loans owed and shares in external companies.

Figure 1: Long-Term Assets at 31 March 2023



3.10 Three of the categories above also represent a source of revenue income to the Council on an ongoing basis. The latest financial returns for 2022/23 are shown in the table below and represent an overall 4.2% rate of return on asset value.

Table 1: Commercial Income 2022/23 (per Commercial Investment Indicators)

Investment Category	2022/23 Income £000
Service Loans (i)	(1,554)
Service Shares (ii)	(8,200)
Investment Property (iii)	(13,044)
Total Commercial Assets	**(22,798)**

(i) Interest received and accrued

(ii) Dividends

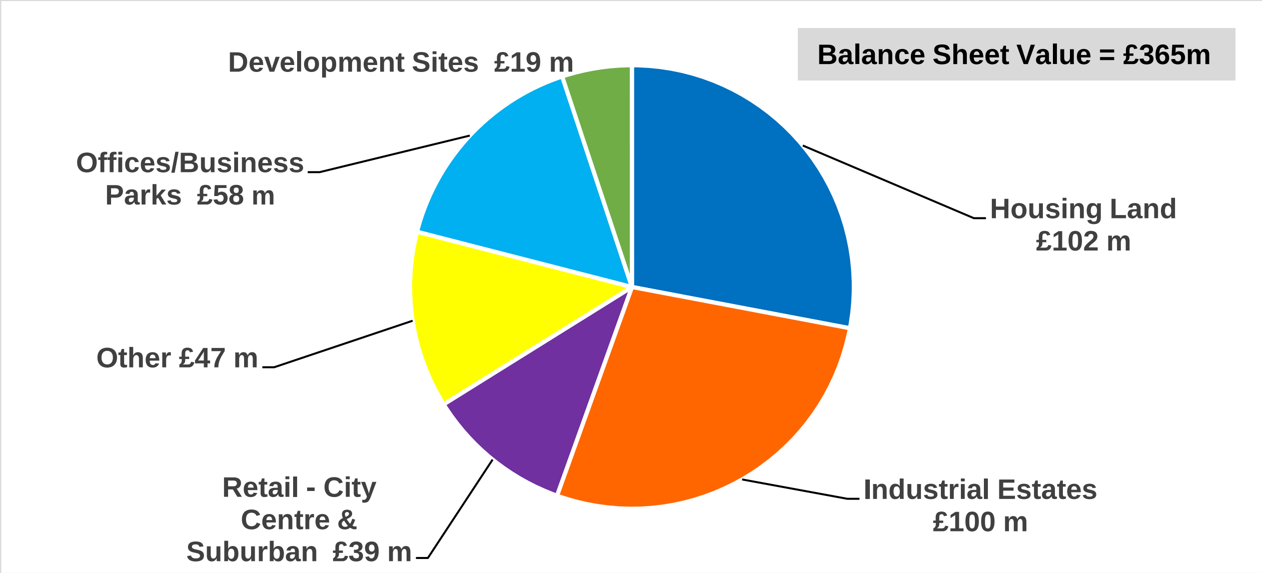
(iii) Rental income net of service charge, voids & other direct costs

3.11 It is important to recognise some of the risks that are involved in owning these types of assets. One set of risks can be categorised as capital or price risks. An organisation to which the council has provided a loan might not pay the Council the full amount owed or the value of an investment, whether shares or property could fall in certain circumstances. This was witnessed during the Covid pandemic but can apply equally during other periods of financial downturn or in relation to specific circumstances such as the individual trading performance of a company in which shares are held. As a result of any of these or other events there may be a possible need to write-off or impair amounts to revenue. Depending on the specific asset type such an impairment may have a real monetary impact on the revenue bottom line or may result in a notional (non-monetary) transaction.

3.12 A further set of risks can be categorised as revenue or income risks. The respective assets might return less income in the form of interest (loans), dividends (shares) or rents (property). If any of these asset classes have been purchased by borrowing then a double risk might arise because the Council will need to continue to repay its borrowing despite any falls in income received. For an organisation like the Council, there can be reputational due to their position I the public eye and the fact that transactions involve public money – the bar set for publicly funded organisations is often much higher that for private organisations in this respect.

3.13 The following sections look at some of the asset categories in more detail.

Figure 2: Investment Property at 31 March 2023



3.14 The Council's investment property represents the largest share of its commercial assets (£365m of the £542m in the long-term assets table above). The values are subject to revaluation each year. The balance sheet value and the £13m revenue income stream achieved in 2022/23 identify it as the single largest area of risk for the Council's commercial assets.

3.15 There are good reasons why this is not regarded as a significant financial risk to the Council. The vast majority of the assets are ones that have been owned by the Council for many years and/or have been purchased by means other than borrowing. Therefore, the Council is not faced with the need to meet a repayment cost for the assets. The overall value of the investments, whilst substantial, is not disproportionate to the overall size of the Council's balance sheet and reflects ownership plus organic growth over many years rather than as a result of an extra-ordinary recent intervention. The assets are spread across a range of classes with the largest class representing less than one-third of the overall value. This means that a financial shock which had a disproportionate impact on a particular class might have a limited impact elsewhere within the portfolio. In addition, over the medium to long-term, historical patterns show that property is a reliable investment with a strong likelihood of values increasing.

Service Loans

3.16 Table 2 sets out the loans that the Council has made with the large majority of these approved over the past 6 years.

Table 2: External Loans (Resources Invested or Committed) 2023/24

Major Loans	Actual Q1 £m	Commitments £m	Total £m
Coombe	8.2	1.9	10.1
Friargate	6.2	0.0	6.2
Friargate - Hotel	2.1	0.3	2.4
UKBIC	13.8	0.0	13.8
CWRT	2.7	1.0	3.7
MRF - Domestic	12.0	0.3	12.3
MRF – Commercial*	0.5	22.2	22.7
Kickstart	2.5	0.0	2.5
Other	4.5	1.0	5.5
Total	**52.5**	**26.6**	**79.1**

The latest indication is that the Materials Recycling Facility commercial loan (commitment) is not now required.

3.17 These loans are all constructed to deliver a commercial return and the Council is bound by Subsidy Control regulations which demand that loans have a market rate of interest. Table 1 above shows that whilst the Council is currently receiving income in the form of interest payments (£1.5m in 2022/23) this is trivial in comparison to the Council's overall budget and would not be considered a primary motivation for making such loans. Instead, it is of paramount importance that loans are aligned to the Council's existing policy priorities and delivery of service objectives and any decision by the Council to approve such loans is driven by this as the primary motivation.

3.18 These loans are of course at risk of non-repayment and ultimately of write off. Each formal decision to make a loan is subject to consideration of these risks and the mitigations in place to control them. In totality the overall level of loans is significant, but each individual loan is modest in proportion to the overall size of the Council and the more significant ones are backed by physical assets which are used as security against the risk of default.

Company Shares

3.19 The Council's company shareholdings are valued at c£125m per the latest set of valuations undertaken as at 31st March 2023. This reflects the market (fair) value which is calculated broadly in relation to the financial activity and performance of each company. The component parts of the Coventry Municipal Holdings Ltd Group have been disaggregated for the purpose of this report.

Table 3: Company Shareholding Values

Shares	Resource Invested £m
Birmingham Airport Holdings Ltd	11.6
The Coventry and Solihull Waste Disposal Company Ltd	0.0
Tom White Waste Ltd	14.6
Coventry Municipal Holdings Ltd	0.0
Coventry Regeneration Ltd	0.0
Coventry Technical Resources Ltd	0.0
Coombe Abbey Park Ltd	9.1
Friargate Joint Venture Project Limited	10.5
UK Battery Industrialisation Centre Ltd	5.5
Sherbourne Recycling Ltd	0.2
Total	**51.5**

Revaluation Balance	**73.5**
Balance Sheet Value	**125.0**

*Accounting rules dictate that £5.5m of the Council's £18m loan to UKBIC at nil interest should be treated as an investment in a subsidiary company as shown above. In reality the whole of the £18 represents a loan rather than reflecting part-loan, part-investment.

3.20 The table also shows the initial amount invested by the Council. The difference between this and the Balance Sheet Value is the result of market revaluations undertaken on a regular basis which can increase or decrease the assessed value of individual companies and is not linked to the initial acquisition price. An initial amount invested of £10m for the Coventry and Warwickshire Waste Disposal Company (CSWDC) is not reflected. This was in the form of preference shares issued as part of the initial investment in CSWDC which were later redeemed as part of a company re-structure.

3.21 All of the 2022/23 dividend income shown in Table 1 came from CSWDC. Dividends have been received previously from Tom White Waste Ltd, Coombe Abbey Park Ltd (CAPL) and Birmingham Airport, all of which were affected significantly by the covid pandemic. From a purely financial perspective, the diversity of shareholdings is designed to protect the Council from a concentration of dividends from one source although the degree of financial shock from Covid was clearly not one that could have been easily anticipated. Strong indications have been given that some of the other companies will return to profitability in the near future starting with Birmingham Airport and SRL in the first instance.

3.22 It is important to note that the Council's acquisition or establishment of each company will be strongly aligned to its policy and service objectives. Between them CSWDC and SRL provide strong synergies with the Council's existing waste collection, management and recycling responsibilities, protect the Council from some of the volatility in waste markets, provide the opportunity to rationalise some of the costs of waste management and enable the production of a local source of green energy from waste. CAPL provides strong synergies with the existing country park facilities at Coombe and protect existing rental income streams. The Friargate Joint Venture Project enables the Council to manage a long-term regeneration plan within the Friargate District.

3.23 Notwithstanding that some of these companies have lost value compared with the resources initially invested, the Council's shareholdings should be viewed as long-term assets. The Council would only seek to dispose of such assets and realise their value if this was seen to be advantageous from both a financial and policy perspective. In this sense the current balance sheet valuations are not a significant factor in terms of the Council's day-to-day financial position.

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Appendix 1: 2023/24 Fees and Charges

	2023/24 Budget £m
Fees - Social Care	(20.2)
Fees - Waste	(10.1)
Fees - Corporate Services	(6.6)
Fees - Planning & Regulatory Services	(5.3)
Fees - Bereavement Services	(4.8)
Fees - Education	(4.5)
Fees - Car Parks	(4.2)
Fees - Parking Enforcement	(3.7)
Fees - Transportation & Highways	(2.5)
Misc. Sales income	(1.6)
Fees - Other External	(1.3)
Income - Miscellaneous	(1.3)
Fees - Housing	(1.1)
Revenues and Benefits	(1.0)
Fees - Facilities & Property Services	(0.9)
Fees - Register Office	(0.9)
Godiva Festival Income	(0.7)
Outdoor Education Centre income (non schools)	(0.6)
Outdoor Education Service – In City Offer	(0.5)
Fees - Fleet Services	(0.5)
Fees - Leisure Activities	(0.4)
Fees - Streetpride & Parks	(0.4)
Fees - Pest Control & Animal Welfare	(0.4)
Fees - Training	(0.4)
Commercialisation - Sponsorship Activities	(0.3)
Procurement Rebates	(0.3)
Fees - Land Search	(0.3)
Fees - Adult Education	(0.2)
Fees - Environmental Services	(0.2)
Fees - Legal	(0.1)
Fees - Post	(0.1)
Fees - Libraries, Advice, Health & Information Services	(0.1)
Fees - Building Sustainable Communities	(0.1)
Licensing - Commercial	(0.1)
Fees - Major Projects Development & Transformation	(0.1)
Salary Deductions	(0.1)
Total	(75.9)

Excludes rents and dividends and £12.3m derived from Business Rates and Council Tax Collection Fund surpluses.