Appendix 7

Commercial Investment Strategy

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) and 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 authority's approach to ***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 approach to investment for yield.

The Council's Commercial Investments

The Council holds investments that, whilst commercial in certain respects, fulfil significant service or policy objectives, through providing wider public services, including supporting economic growth. These investments are categorised as shares, loans, and property:

- **Shares in companies,** with the main holdings being in 6 companies: the Coventry & Solihull Waste Disposal Company, Birmingham Airport, Sherborne Recycling Ltd, Coventry Municipal Holdings Ltd, Friargate JV Project Ltd and the UK Battery Industrialisation Centre (UKBIC). In total, shares held by the Council had a value of £125m as at 31/03/2023 (£96m at 31/3/2022). Much of this represents increases in the value of the shares rather than cash funds invested. An estimated £52m of the £125m represents capital funds invested over time. Share dividend income totalled £8.2m in 2022/23.

  In respect of holding shares the Council faces two main financial risks: a fall in dividend income and a fall in the value of the shares, with the potential that the initial investment may not be recovered. In order to limit this risk, an upper limit of £55m (Indicator 5) is maintained 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 £291m as at 31/3/2023 (£302m as at 31/3/2022) with forecast net rental income of £12.1m in 2023/24. The fair value of commercial property is assessed annually.

- **Loans provided and committed** by the Council ("service loans") are forecast to total £56.4m as at 31/3/2024 with the significant main loans provided or committed to: Sherborne Recycling Ltd (£14.4m); Coombe Abbey Park Ltd loans (£9.8m); UKBIC (£14.4m) Friargate Holdings 2 Ltd (£6.5m) and SMEs and other local business funding through Coventry and Warwickshire Reinvestment Trust (£2.8m).

  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 £70m (Indicator 4) is set on the sum invested, excluding any change in the value of service loans already held. This total is £21m lower than the 2023/24 limit of £91m, due to the Council no longer planning to invest in commercial recycling infrastructure, with this being financed through other investment sources.

  The total of the share and loan limits referred to above is £125m (shares £55m and loans £70m). In some respects the limits can be viewed as a combined total for *financial* contributions to developments, as opposed to investment by the council directly in acquiring or building physical assets.

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 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. Business cases for individual investments, will include the purpose of the investment and how it meets Council objectives.

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

Although not investing primarily for yield (see section "Borrowing to Fund Commercial Investment", below), the Council nevertheless assesses the risk of loss before making and also whilst holding commercial 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 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 is forecast to generate total commercial income of £21.5m in 2023/24 (loan interest £1.8m, share dividends £7.6m and net property rents £12.1m). Whilst a significant cash sum contributing to the balancing of the Council's budget, this figure represents 8.3% of the Council's net revenue stream. In generating 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

The Treasury Management Strategy (section 2.4) sets out the benefits of the Council retaining access to PWLB borrowing. The authority will continue the policy of not investing in assets primarily for yield regardless of how the investment is funded, as this would jeopardise access to PWLB borrowing and be inconsistent with the Prudential Code (below). Under formal PWLB Guidance investment in the following areas are not deemed to be investment for yield: service delivery (education, highways & transport, social care, public health, culture & related services, environmental & regulatory services, police, and fire & rescue services); housing; regeneration; preventative action; refinancing and treasury management. Where individual projects have characteristics of several different categories, the section 151 officer of the authority is required to use their professional judgment to assess the main objective of the investment and consider which category is the best fit.

In addition, the requirements of the Prudential Code are in line with the rules for PWLB borrowing. The Code sets out the framework in which authorities are to manage commercial investments, classifying investments as being for one of three purposes:

- Treasury management, broadly for cashflow or treasury risk management purposes;
- Service delivery, held primarily and directly for the delivery of public services;
- Commercial return, held primarily for financial return with no treasury management or direct service provision purpose. This category can include commercial property.

In respect of investments for commercial return:

- The risks should be proportionate to the authority's financial capacity – i.e. that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services;
- Authorities must not borrow to invest primarily for financial return;
- However, authorities with commercial land and property can invest in maximising its value, including repair, renewal and updating of the properties;

In addition, the Code:

- states that it is imprudent for authorities to make any investment or spending decision that could increase the need for borrowing, unless it is related to the authority's functions and where financial returns are "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".
- confirms that authorities are not required to sell investments. However, they will need to review options for exiting commercial investments before borrowing, considering the value for money of taking out borrowing versus selling investments. In addition, a review will need to be included in the annual treasury or investment strategy.

In order to proactively manage risk and in line with proposed revisions to the statutory Minimum Revenue Provision (MRP) guidance, the authority will make MRP 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 ways, 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 case 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;
- This Commercial Investment Strategy, and associated indicators, support 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 is 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.

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 6b:

- **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 2024/25 (25% in 2023/24).

- **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 26%

of total council assets by current value (as at 31/03/2023), indicating that assets provide approximately 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 income return on commercial investments is forecast to be 5.4% in 2024/25 (4.5% forecast for 2023/24).

- **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 Revenue Stream (Indicator 6) and Commercial Income: Net Revenue Stream (Indicator 7).** These indicators demonstrate the proportionality, both of the level of the Council's debt and of its reliance on commercial income. Debt is forecast to represent 117.9% of NRS in 2024/25 (122.2% for 2023/24) and commercial income 9.2% in 2024/25 (8.3% for 2023/24).

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