Coventry City Council

Briefing note

To: Finance and Corporate Services Scrutiny Board 1

Date: 12th February 2025

Subject: Commercial Investments and Income Generation

1 Purpose of the Note

1.1 This Briefing 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 outlines the content of the Council's Commercial Investment Strategy including details about the overall commercial portfolio and performance.

2 Recommendations

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

1. Note the contents of the Briefing Note, presentation and Appendix 1

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 investment 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 2024/25 Budget Report (February 2024) identified gaps of £14m and £15m for 2025/26 and 2026/27 whilst the most recent monitoring report to Cabinet (December 2024) highlighted further budgetary pressure which indicates a worsening position both for the Council and the wider sector.

3.3 Reduced real term funding and the ongoing need to balance budgets has, for many years, led councils to adopt commercial approaches to improve their financial positions, and maintain service quality as far as possible. 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 summarised at Appendix 1.

3.4 Recent years have witnessed increased activity nationally of a more speculative nature (most 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 s114 Notice.

3.5 A s114 Notice is an indication that expenditure of an authority will exceed resources for the year, & means that no new expenditure is permitted, except for that to fund statutory services. The current financial climate within which Local Authorities operate means that the risk from normal operations is heightened, such that resilience to shocks is reduced.

3.6 There was 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 increased intervention and regulation further aimed at reducing the risk of future such occurrences. This has led to the introduction of commercial investment strategies, revisions to the Prudential Code (requiring proportionality), and changes to rules for borrowing from the PWLB (preventing investing primarily for yield).

The Council's Approach

3.7 Whilst it is difficult to definitively benchmark it is likely that the Council is broadly 'within the pack' regarding income it generates from charging for discretionary and traded services. These are activities that occur mostly as a result of 'business as usual' activity.

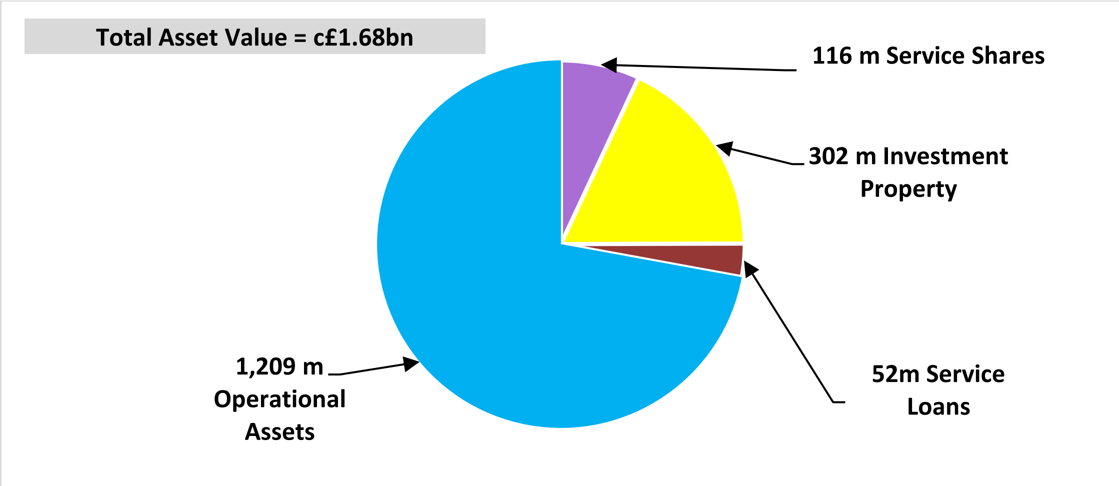
3.8 Coventry holds a relatively large commercial property portfolio compared with other councils, and the Council has been active in terms of providing external loan finance over a number of years and has a variety of company shareholdings compared with similar authorities. It is these types of activity that have a higher risk profile and have prompted the interest of regulators in recent years.

3.9 Like other councils, the Council's approach has been informed by the need for it to generate new income streams to help offset reduced government resources over many years to support its budgetary position and protect public services. However, at a local level, each commercial intervention made by the Council has also had strong policy and/or service justification. These activities 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

3.10 The following chart shows the latest estimate of the key categories of long-term assets on the Council's balance sheet. The vast majority (72%) of is held in the form of operational assets, essentially land, buildings and infrastructure owned by the Council from which services are delivered. 18% is represented by investment property which generates a commercial rent and whose valuation is essentially driven by that rent. The remaining 10% is held in the form of long-term loans to third parties and shares in external companies.

Figure 1: Long-Term Assets at 31 March 2024



3.11 Three of the categories above also represent a source of revenue income to the Council on an ongoing basis. The latest financial returns for 2023/24 are shown in the table below and represent an overall 5.7% rate of return on asset values as at March 2024.

Table 1: Income received Per Investment Category

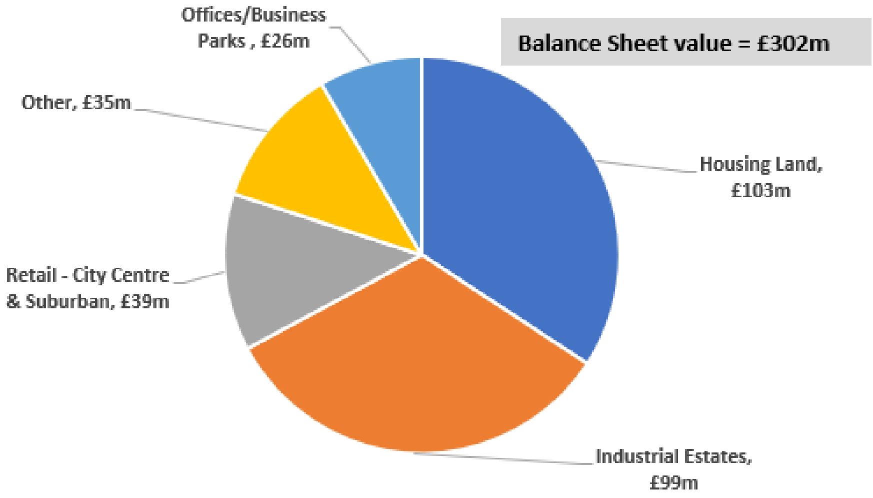
Investment Category	**2021/22 Income £000**	**2022/23 Income £000**	**2023/4 Income £000**
Service Loans (interest received)	(1,637)	(1,554)	(1,665)
Service Shares (Dividends)	(9,650)	(8,200)	(12,372)
Investment Property (Rental income net of voids & service charges)	(11,509)	(13,768)	(12,597)
Total Commercial Income	**(22,796)**	**(23,522)**	**(26,634)**
Return on Investment	**4.9%**	**4.7%**	**5.7%**

3.12 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 value (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, be they 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.

3.13 A further set of risks can be categorised as income risk, whereby assets may return less income in the form of interest, dividends or rent. If any of these assets have been purchased by borrowing, then additional risk might arise as the Council would need to continue to repay borrowing despite reduced income received. For an organisation like the Council, there can be reputational risk due to their position in the public eye and the fact that transactions involve public money. The bar set for publicly funded organisations is often much higher than for private organisations in this respect.

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

Figure 2: Investment Property at 31 March 2024



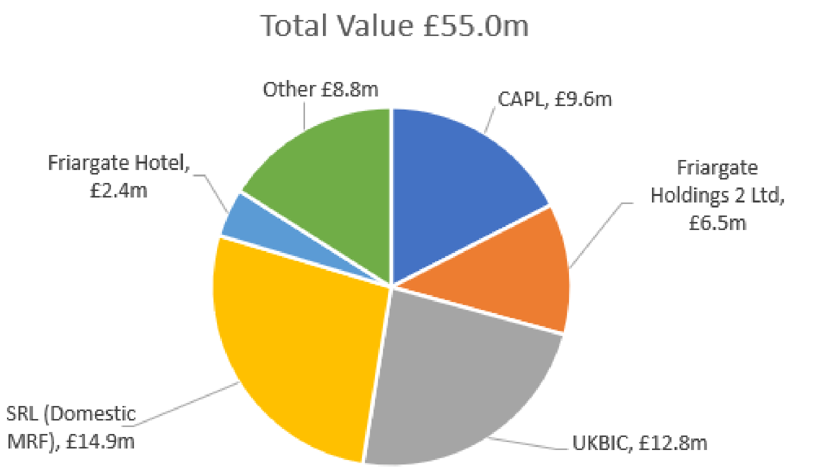
3.15 The Council's investment property represents the largest share of its commercial assets (£302m in Fig. 1 above). The values are subject to revaluation each year. The balance sheet value and the £12.6m revenue income stream achieved in 2023/24 identify it as the single largest area of risk for the Council's commercial assets.

3.16 There are however good reasons why this is not regarded as a significant financial risk. Most assets have been owned for many years and purchased by means other than borrowing, such that the Council is not required to meet loan repayment costs. The overall value of investments, whilst substantial, is not disproportionate to the size of the Council's balance sheet and reflects ownership over many years rather than the result of extra-ordinary recent intervention. Additionally, assets are spread across a range of classes, the largest representing a 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

3.17 Table 2 overleaf sets out approved loans, the large majority of these over the past c10 years.

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



Major Loans	Actual 31/03/2024 £m	Commitments £m	Total £m
Coombe	7.7	1.9	9.6
Friargate	6.5	0.0	6.5
UKBIC	12.4	0.4	12.8
CWRT	2.8	0.0	2.8
MRF - Domestic	14.4	0.5	14.9
Friargate Hotel	2.4	0.0	2.4
Other	6.0	0.0	6.0
Total	**52.2**	**2.8**	**55.0**

3.18 These loans are constructed to deliver commercial returns, & the Council is bound by Subsidy Control regulations requiring loans to have market interest rates. Whilst the Council is currently receiving income (interest) of £1.7m in 23/24, this is low compared to the Council's budget and is not 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.

3.19 These loans are of course at risk of default and potentially write off. Decisions to make loans and relevant interest rates, are subject to consideration of risks and mitigations (e.g. security) in place. The overall level of loans is significant, however individual loans are low relative to the overall size of the Council. The more significant ones are also backed by physical assets or indemnities which are used as security against the risk of default.

<u>Company Shares</u>

3.20 The Council's shares in table 3 below are valued at c£116m as at 31st March 2024, reflecting fair market value, based on company financial activity & performance.

Component parts of Coventry Municipal Holdings Ltd Group have been disaggregated for the purpose of this note.

Table 3: Company Shareholding Values

Shares	Resource Invested £m	Balance Sheet Value £m
Birmingham Airport Holdings Ltd	11.7	36.7
The Coventry and Solihull Waste Disposal Company Ltd	0.0	68.0
Tom White Waste Ltd	14.9	6.6
Coventry Municipal Holdings Ltd	0.0	0.1
Coventry Regeneration Ltd	0.0	0.0
Coventry Technical Resources Ltd	0.0	2.8
Coombe Abbey Park Ltd	9.1	0.1
Friargate Joint Venture Project Limited	10.5	2.2
UK Battery Industrialisation Centre Ltd*	0.0	0.0
Sherbourne Recycling Ltd	0.2	0.0
Total	**46.3**	**116.5**

*Excludes UKBIC £5.1m which represents a technical classification of investment rather than cash

3.21 The table also shows the initial amount invested by the Council. The difference between this and the Balance Sheet Value is the result of regular market revaluations undertaken which can increase or decrease the assessed value of individual companies and is not linked to the initial acquisition price.

3.22 All the 23/24 dividend income shown in Table 1 is from CSWDC. Dividends have been received previously from Tom White Waste Ltd, CAPL and Birmingham Airport, all of which were affected significantly by the covid pandemic, & more recently the high inflation and cost of living crisis affecting the economy. From a purely financial perspective, the diversity of shareholdings, and indeed the wider commercial portfolio is designed to protect the Council from a concentration of dividends or income from one source, although the degree of financial shock from Covid was clearly not one that could have been easily anticipated. Expectations are that some of the other companies will return to profitability in the near future starting with Birmingham Airport and SRL in the first instance.

3.23 It is important to note that the Council's acquisition or establishment of each company is aligned to its policy and service objectives. Between them CSWDC, TWW, & SRL provide strong synergies with the Council's 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 JV Project enables the Council to manage a long-term regeneration plan within the Friargate District.

3.24 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 deemed to be a significant factor in terms of the Council's day-to-day financial position.

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Appendix 1: 2024/25 Fees and Charges

Analysis	2024/25 Budget £m
Fees - Social Care	(22.4)
Fees - Housing	(6.2)
Fees - Bereavement Services	(5.4)
Fees - Corporate Services	(5.0)
Fees - Car Parks	(4.6)
Fees - Parking Enforcement	(4.0)
Fees - Waste	(3.8)
Misc. Sales income	(3.0)
Fees - Planning	(2.7)
Fees - Transportation & Highways	(2.7)
Fees - Licensing	(2.4)
Fees - Facilities & Property Services	(1.7)
Godiva Festival Income	(1.2)
Fees - Leisure Activities	(1.0)
Fees - Register Office	(1.0)
Fees - Planning & Regulatory Services	(0.8)
Outdoor Education Centre income (non-schools)	(0.7)
Commercialisation - Sponsorship Activities	(0.6)
Fees - Fleet Services	(0.5)
Fees - Training	(0.4)
Fees - Pest Control	(0.4)
Procurement Rebates	(0.4)
Fees - Other External	(0.3)
Outdoor Education Service – In City Offer	(0.3)
Fees - Land Search	(0.3)
Fees - Adult Education	(0.3)
Fees - Streetpride & Parks	(0.2)
Fees - Legal	(0.2)
Fees - HR/Employment	(0.2)
Fees - Libraries, Advice, Health & Information Services	(0.1)
Fees - Environmental Services	(0.1)
Fees - Post	(0.1)
Fees - Education	(0.1)
Salary Deductions	(0.1)
Fees - Libraries	(0.0)
Total	(73.2)