COUNCIL – 23 FEBRUARY 2023

INVESTMENT STRATEGY REPORT 2023-24

1.0 Introduction

1.1 The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a Capital Strategy report. The revised Treasury Management Code requires investments and investment income to be attributed to one of the following three purposes:

Type of Investment	Strategy
Treasury management; Day to day investment of surplus cash balances – Treasury Management Investments	Treasury Management Strategy
Service delivery; Loans and acquisition of shares in wholly owned companies, joint ventures and other organisations for service purposes	Investment Strategy
Commercial return; Investments held primarily for financial return with no treasury management or direct service provision purpose	Investment Strategy (The Council does not borrow to invest primarily for financial return)

2.0 Treasury Management Investments

2.1 The Council holds cash balances for day to day use, to make payments to suppliers, contractors and payroll. Balances arise as there are timing differences between Council Tax and Business Rates collected and distributed, and between other income generated and the associated service or debt management costs. The timing of long term borrowing will be determined depending on the interest rates available which may mean that funds are held for a short period before they are required or that short term borrowing is taken which is subsequently refinanced. The Council also holds reserves for future expenditure.

2.2 The consequential cash surpluses are invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £0m and £50m during the 2023/24 financial year. Higher cash balances will be held if long term borrowing rates fall and funds are secured for ongoing projects.

2.3 Cash surpluses are invested to ensure security, liquidity and some income generation from these Council resources in line with the Treasury Management Code.

2.4 Treasury Management Investments are reported each month in the Council's Performance and Financial Monitoring report, the 'Green Book', available on the Council's website.

3.0 Loans for Service purposes

3.1 The Council lends money to its subsidiary companies and joint ventures, suppliers, local businesses and charities, other local service providers, local residents and its employees to support local public services and stimulate local economic growth.

3.2 Provision of loan finance to another organisation can be an effective way for the Council to achieve its objectives whilst benefiting from the expertise or capacity of that organisation.

3.3 These loans are treated as capital expenditure and are financed by borrowing or other available resources. Where capital expenditure is funded by borrowing Minimum Revenue Provisions (MRP) are set aside for repayment of the borrowing. Loan repayments are set aside for the repayment of debt in lieu of MRP.

3.4 The Department for Levelling Up, Housing and Communities (DLUHC) issued consultations on MRP in November 2021 and June 2022. The consultation includes reviewing the approach of using capital receipts in lieu of MRP. The final regulations\guidance have not yet been published. Therefore the MRP policy has not been amended.

3.5 The most significant loans the Council has made are to the Thameswey Group (wholly owned subsidiary) and Victoria Square Woking Ltd. At 31 March 2022 the Council had made £317m of loans to Thameswey Housing to provide housing in the Borough, £84m to Thameswey Energy and Thameswey Central Milton Keynes, to further the Council's energy efficiency policies, £106m to the Thameswey group relating to the Sheerwater project, and £646m to Victoria Square Woking Ltd for the town centre regeneration project.

3.6 Other loans have been advanced to the Peacocks to enable the improvement of the shopping centre, Greenfield School, Kingfield Community Sports, and Freedom Leisure for improvements at the Pool in the Park.

3.7 The main risk when making loans is that the borrower will be unable to repay the principal lent and/or the interest due. Loans are generally secured against assets which means the Council could take the assets in the event of default. The business case for the underlying investment is also considered before funds are loaned.

3.8 The table below sets out the loans for service purposes, as at 31 March 2022, together with commitments for loans for service purposes included in the February 2023 Investment Programme. It is considered that this remains an acceptable level given the diversification of loans advanced and the asset backed nature of loans. These total advances are the upper limits on the outstanding loans to each category of borrower approved by the Council and any additional loan advances would have to be subject to further consideration by the Council.

3.9 To facilitate the delivery of housing the Council allows for 50% of the following years Thameswey Housing approved budget to be drawn in advance. This ensures delivery of new properties is not constrained by changes in the timing of project costs.

Table 1: Loans and Loan Commitments for Service Purposes

Category of Borrower	Actual 31/03/2022 £'000	Investment Programme February 2022 2022/23 £'000	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000
Subsidiaries						
Thameswey Energy Ltd	9,896	7,615	-	3,600	-	1,000
Thameswey Central Milton Keynes Ltd	35,223	3,100	3,300	5,500	5,500	4,100
Thameswey Housing Ltd	269,427	32,337	22,000	32,000	17,000	6,000
Thameswey Solar Ltd	817					
Thameswey Developments Ltd (THL)	47,250					
Thameswey Developments Ltd (TEL)	38,845					
Thameswey Developments (Sheerwater)	5,000					
Thameswey Housing (Sheerwater)	90,167	48,383	63,000	55,000	77,000	-
Thameswey Developments (S/W Leisure)	10,979					
Victoria Square Woking Ltd	645,860	66,140	9,000	9,000	6,000	6,000
Rutland Woking	1,632					
Peacocks	6,350					
Greenfield School	11,262	2,838				
Freedom Leisure	1,640					
Kingfield Community Sports Centre Ltd	1,500					
Local Residents (Mortgages)	1,793					
Loan Re Wolsey Place	1,722					
Loan Re Dukes Court		1,000				
Other	201					
TOTAL	1,179,564	161,413	97,300	105,100	105,500	17,100

3.10 If loans are expected not to be repaid in full, accounting standards require the Authority to set aside a loss allowance, reflecting the likelihood of non-payment. From 2018/19 onwards the Statement of Accounts show the loan balance 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.

3.11 The Council assesses the risk of loss before entering into, and whilst holding, service loans and undertakes further work where necessary to assess:

- who the loan is to be made to - with appropriate enquiries to fully understand the entity where the entity is not already known/associated with the Council;
- the revenue stream associated with the loan to be made;
- the loans will be secured against capital assets where possible to ensure the Council receives the assets in the event of non-repayment. Covenants or legal bonds may be taken against capital assets.

3.12 Credit ratings are not routinely used for known associated entities, but would be used for supplier loans.

Environmental, Social and Governance (ESG)

3.13 The CIPFA Treasury Management Code now seeks to incorporate Environment, Social and Governance (ESG) considerations into Treasury Management Practices (specifically under Treasury Management Practice 1 of the code). The code suggests the scope of what is included: “The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations.”

3.14 This is a developing area in terms of how investments should be evaluated against this requirement. However, the Council’s key objectives encapsulate ESG and it is the Council’s service objectives which determine which non-treasury investments it takes on (not the level of return).

3.15 Moreover the only treasury investments the Council is planning to make in the foreseeable future are in Money Market Funds. Money Market Funds are low volatility funds with conservative investment restrictions offering flexibility for short-term deposits. There are strict rules around portfolio diversification, transparency, and disclosure and risks around ESG are very low.

4.0 Shares for Service Purposes

4.1 The Council may invest in the shares of its subsidiaries, its suppliers, local businesses and organisations and other jointly owned public sector led activities, to support local services and stimulate local economic growth.

4.2 All investment in shares is treated as capital expenditure and is financed by available resources or borrowing. Where capital expenditure is funded by borrowing Minimum Revenue Provisions (MRP) are set aside for repayment of the borrowing which may be calculated to match asset life, or over a shorter period in line with the Council's MRP policy (Appendix A).

4.3 Shares have been used to provide subsidy into Thameswey Housing Ltd. As the shares do not have interest payable on them, the company is able to provide rents at sub market rates. The shares in Woking Necropolis and Mausoleum Ltd relate to the acquisition of the Cemetery. Whilst the cemetery business generates some income it would not be sufficient to meet financing costs associated with the purchase.

4.4 The Council has also invested in shares to support activity where the funding could otherwise have been through provision of a grant. The Municipal Bonds Agency (Local Capital Finance Company) is one example of this, where the Council has supported a sector wide initiative. The Credit Union investment is another example. In some circumstances it may be beneficial, for service and partnership reasons, to acquire an interest in the organisation as well as providing financial support.

4.5 If shares were being held as an investment, to achieve dividend income and for future sale, a fall in value whereby the initial outlay may not be recovered would be a risk. However, since the Council's investments in shares have been financed with any associated borrowing being repaid over time, or where the underlying expenditure is a long term asset, it is not considered that this is a significant risk.

Table 2: Shares for Service Purposes

Investment	Actual 2021/22 £'000	Investment Programme February 2023 2022/23 £'000	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000
Thameswey Ltd	31,193	No further share capital planned in Investment Programme February 2023				
Woking Necropolis & Mausoleum Ltd	6,000					
Victoria Square Ltd	14					
Local Capital Finance Company	50					
Boom Credit Union	50					
Woking Town Centre Management	1					
Kingfield Community Sports Centre Ltd	500					
TOTAL	37,808	-	-	-	-	-

4.6 The Authority assesses the risk of loss before entering into and whilst holding shares depending on the long term objective of the funding provided.

4.7 As shares are treated as capital expenditure, rather than investments for the purpose of financial income, investments in shares are not considered to be liquid in nature. That is, they cannot be readily converted back to cash through sale.

4.8 The Authority does not invest in any non-specified investment types. The government defines a non-specified Investment as a financial investment that is not a loan and does not meet the criteria to be treated as a specified investment. See Appendix D for definitions of specified and non-specified investments. Shares are treated as capital investment and therefore do not meet this definition.

5.0 Strategic Property Investments \ Commercial & Service Investments

5.1 The changes to the Treasury management and Prudential Codes (published in December 2021) require that the purpose, objectives, and management arrangements for commercial & service investments need to be defined in the Council's treasury management strategies from 2023/24 onwards.

5.2 Government guidance defines property to be an investment if it is held primarily or partially to generate a profit. The Council's Strategic Property portfolio, including assets held for future redevelopment are included in this category. However the Council does not acquire assets primarily for yield and the following paragraphs relate to the sustainability of strategic purchases made in order to meet Council service objectives such as regeneration.

5.3 The strategies recognise that the authority must not borrow to invest for the primary purpose of commercial return and new borrowing must directly and primarily relate to the functions of the authority.

5.4 In recent years the Council has invested in property if there is a strategic reason for the acquisition. Strategic property assets may be affordable to hold in the long term and may be held for a variety of reasons including:

- Proposed redevelopment of the site or surrounding area
- Future potential redevelopment of a site or surrounding area
- To influence commercial use of a site
- Consolidation of interests in a site
- To acquire part of a site for an alternative use
- To maintain a property with an existing use, or to make it available for an alternative use
- As a result of a relationship with a strategic partner, other public sector body or business within the Borough

5.5 The Council's commercial property portfolio has been acquired over time and comprises office, retail and industrial assets within Woking. The Council employs an Estates Management Team to oversee the management of these commercial properties. Where appropriate external management agencies are also appointed to manage the rental income, maintenance, and service charge arrangements of commercial units.

5.6 Since 2016/17 the Council has allocated borrowing to secure specific strategic property within the Borough and drive local economic regeneration. The financial position of these assets is reported in the Green Book. Properties are held for long term strategic purposes and are treated as capital expenditure with the financing interest and repayment costs charged to revenue budgets.

Table 3: Strategic Property acquired since 2016/17 and generating a commercial income (For financial performance see monthly Green Book reporting)

Property	Date of Acquisition	Net Income (Dec 2021) £'000	Acquisition Costs £m	Additional Investment £m	Accounts 31.3.2022 Gains or Losses £m	Accounts 31.3.2022 Value in Accounts £m
Cleary Court	2016/17	8	3.6	0.5	-1.1	2.9
Morris House	2016/17	-29	4.7	1.3	-3.6	2.3
6 Church St West	2016/17	370	11.5	0.4	-1.3	10.6
Orion Gate	2016/17	924	22.7	0.2	-1.6	21.3
Dukes Court	2017/18	2,092	71.4	0.7	-10.9	61.2
Red House	2018/19	42	6.3		-0.9	5.4
CMS House	2018/19	48	2.0		-0.9	1.1
Victoria Gate	2018/19	478	37.9	5.0	-2.3	40.6
Midas House	2018/19	-266	25.3		-4.1	21.2
Albion House	2018/19	441	28.9		-5.3	23.6
Commercial Buildings	2019/20	88	4.0		-1.4	2.7
1 Christchurch Way	2019/20	279	11.5		-1.4	10.1
Goldsworth Park Shopping Ctr	2020/21	257	17.1		-0.8	16.3
36 to 42 Commercial Way	2020/21	75	2.0		-0.2	1.8

Excludes properties purchased under the HIF Project.

5.7 Within the base commercial rents originating prior to 2016/17, the most significant assets were the Council's interests in the Wolsey Place and Peacocks shopping centres, industrial estates across the borough and town centre office buildings.

5.8 The government guidance considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. Valuations vary depending on many factors including the local, national and global economic climate. For property investments the valuation is directly related to the rental income achieved, a vacant area may therefore have a significant impact on the valuation.

5.9 Whilst it is important to monitor the property valuations, the Council has treated these acquisitions as capital expenditure and appropriately funded these assets. Repayment of the costs is being provided on an annuity basis. The property assets are not being held for sale as a means to repay borrowing, the intention has been for them to be held for the long term. The Council's property portfolio, however, remains under regular review and assets will be subject to disposal where opportunities arise.

5.10 All properties are valued on an annual basis to provide a fair value for the preparation of the Council's accounts. Any impact of a change in valuation will be reported following the completion of the annual accounts.

5.11 The Council assesses the risk of loss before entering into and whilst holding property acquisitions. Consideration is given to the operational service or strategic benefit/opportunity provided by acquisition of the asset set against the risk of loss of income to service the capital expenditure. In each case the Council/Executive will receive information on the tenancies and likely income to be achieved from any vacant areas. Investment is in the context of the long term development plans and vision for Woking, and level of reserves to mitigate any economic downturn. No purchases are made for profit, all acquisitions are made in order to meet service objectives.

5.12 Property is held as a long term strategic asset and not a short term financial asset. It is funded as capital expenditure and it is not therefore being held with a view to being able to convert to cash at short notice, as a treasury investment would be. Where funding is by borrowing, the borrowing is long term to correspond with the long term nature of the asset. The Council's policy for repayment of the borrowing (MRP) can be found at Appendix A and determines that repayment is on an annuity basis for commercial property. This ensures that there is sufficient resource set aside to repay the borrowing as it becomes due. As borrowing is repaid, the debt associated with the asset reduces.

5.13 Consideration is given on an annual basis to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt, through the Council's Strategic Assets group. In 2022/23 the review of the Council's strategic property portfolio resulted in the Executive approving the disposal of a £3m property. Due to the financial position of the Council this disposal has been identified to fund transformation programmes rather than repaying debt.

6.0 Proportionality

6.1 Prior to the pandemic the Council had been able to increase service activity and support to the local community through use of the income generated from investments in group companies and strategic commercial income. Without this income, services would have had to be reduced at a time when they have been needed most as other support for the vulnerable is under pressure. The changes to the Treasury Management Code and PWLB Borrowing rules (as covered in last year's report) mean that Woking can no longer make acquisitions which could be seen as primarily for yield despite having sound strategic reasons.

6.2 Income has also supported the Council's long term redevelopment of Woking Town Centre, achieving a better offer for local people, attracting businesses and employers to the Borough and contributing towards housing needs. The long term assets driving these improvements are funded by borrowing whilst the income they generate in direct rents or investment income contribute to offsetting these costs.

6.3 Table 4 below shows the balance between expenditure planned to meet the service delivery objectives and/or place making role of the Authority, interest costs on borrowing and investment/commercial rental income.

Table 4: Proportionality of Investments

	2021/22 Actual £m	2022/23 Forecast £m	2023/24 Budget £m	2024/25 Budget £m	2025/26 Budget £m	2026/27 Budget £m
Gross Service Expenditure (GSE)	70.6	67.3	66.9	67.3	69.4	70.3
Interest & Repayment (MRP) costs	54.5	54.6	62.1	65.7	67.0	67.0
Treasury Investment Income	-32.5	-38.9	-43.3	-45.8	-47.6	-47.6
Commercial Rental Income	-21.5	-20.0	-19.1	-19.1	-19.1	-19.1
(Treasury + Commerical income)/GSE	-76%	-88%	-93%	-96%	-96%	-95%

6.4 The Council had accumulated reserves to mitigate temporary reductions in rental income, and to provide time for any long term adjustment in rents to be managed. As discussed in the General Fund Budget Report elsewhere on the agenda, these reserve balances are being used at a much faster rate than anticipated. The details on presenting a balanced budget are included in the General Fund Budget Report.

6.5 The Council's borrowing has been spread over many assets with residential property as well as strategic commercial properties in different sectors (retail, office) and let to a variety of tenants across different industries. This reduced the impact of an issue with any individual tenant or type of tenant.

7.0 Capacity, Skills and Culture

7.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Finance Director, Financial Services Manager and senior members of the Finance team are qualified accountants with many years' experience. The Council has a Strategic Asset Manager and Estates Management team with experience in managing properties, and valuation. The Council also has an in-house legal team led by the Director of Democratic and Legal Services (Monitoring Officer).

7.2 During 2022/23 corporate capacity has been increased through the development of the Fit for the Future project team. Further resources will be required during 2023/24 to fully establish the Shareholder Advisory Group (SAG).

7.3 External advisors and consultants are used where the Council does not have the technical knowledge, experience or skills required. They are also used to supplement the internal resource if Council staff do not have the capacity to manage the Council's requirements.

7.4 The Council supports training towards professional qualifications and for staff to attend relevant training courses for continued professional development. There is a Members' development programme and the Council has the Charter mark for Member Learning and Development. In October 2019 the Council was awarded the Investors in People Silver accreditation and the Health and Wellbeing Good Practice Award. Specific training and briefing sessions are organised on subjects or projects as needs are identified (for instance Link Group providing a member briefing in 2022/23 on interest rate assumptions in order to help inform decisions regarding the Victoria Square Woking Ltd Loan Facility).

7.5 Further training options for members will be considered through 2023/24.

8.0 Investment Indicators

8.1 The Authority has set the following quantitative indicators to provide information on the Authority's total risk exposure as a result of its investment decisions.

<u>Total risk exposure and funding</u>

8.2 Total risk exposure is 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.

Table 5: Total Investment Exposure

Total Investment Exposure	31.3.2022 Actual £m	31.3.2023 Forecast £m	31.3.2024 Forecast £m
Treasury Management including Money Market Funds and Bank balance	36	2	2
Service Investments: Loans	1138	1300	1,397
Service Investments: Shares	38	38	38
Commercial Investments: Property (at valuation)	349	349	349
TOTAL Investments	1,561	1,688	1,786

8.3 The Council is generally in an underborrowed position due to the ongoing borrowing requirement. This means that the Council's reserves and working capital balance is being used to reduce the actual borrowing taken. This has been the Council's approach for some years and using the balances in this way enables the Council to delay drawing and paying the interest costs on long term borrowing. In setting the annual revenue budget it is assumed that the underborrowing position is corrected and that long term borrowing is taken to re-instate those reserves temporarily used.

Rate of return

8.4 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. The Strategic Property Investment target rate of return shown in table 6 has been maintained at 1.5%. This reflects the underlying lease income during 2020/21. Not all commercial lease income was received during the pandemic and Officers are still working with tenants to recover further income. No further commercial investments are planned and the rate of return is expected to increase gradually over the life of the underlying assets.

Table 6: Investment Rate of Return (net of all costs)

Investments net rate of Return	2021/22 Actual	2022/23 Forecast	2023/24 Budget
Treasury Management Investments	0.07%	1.30%	0.9%
Service Investments: Loans	0% - 2%		
Service Investments: Shares	Nil - do not expect any return on shares		
Strategic Property Investments since 2016/17 *	1.5%	1.5%	1.5%

Consideration of Other Indicators

8.5 The Capital Strategy and Treasury Management Strategy include additional focussed indicators which are not replicated here.

8.6 Monthly reporting through the Green Book enables performance to be assessed during the year and for the up to date position to be tracked. The Strategic Property performance shows the current status of assets acquired since 2016.

8.7 Consideration will be given to further performance indicators, to be included in future years, which would complement the information included in this report.