Commercial Investment Strategy

Appendices

1. CIS Business Plan (to follow once approved)
2. “Plan on a Page”
3. Delivery Options

Date Approved: xx/xx/2015
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Version 1

1. Introduction

Over the medium term, the Council faces considerable "revenue" financial challenges. The Medium Term Financial Strategy (MTFS) approved in February 2015 showed a revenue gap of £2.4m by 2019/20, with extensive use of General Fund reserves required over the MTFS period. While setting budgets in line with the MTFS would maintain a level of reserves above the £3m minimum agreed by Cabinet, such use of reserves does not support the "principles of financial sustainability".

As shown on the "Plan on a Page" (Appendix 2), the Council's ambition to remove its reliance on Central Government funding increases the funding gap to £8.2m. The "Plan on a Page" shows that the Council aims to bridge this funding gap through a number of core business activities. As well as alternative service delivery models and budget change programmes, the "Plan on a Page" recognises income generation as one of those core activities.

The "Commercial Investment Strategy" (CIS) will be one of the main components of generating income. The CIS has been developed in conjunction with consultants EC Harris and sets out a framework for investing in a wider portfolio of commercial type properties. The focus of the CIS is to deliver a growing and significant commercial return and sustainable revenue stream for the Council.

The Council already generates a 7.2% net return from its current £20.8m commercial estate, contributing £1.5m in net revenue to help fund services. With a 10-year average return of 6.2%per annum for commercial property nationally, it is expected that further investment will provide a significant, sustainable long term revenue income for the Council.

2. Strategic Objectives

The CIS is expected to contribute towards three of the four Strategic Priorities in the Council's Corporate Plan 2015-16. The income generated will help to fund all services.

Strategic Priority	Link to CIS
Ensuring we are a customer focussed and service led Council – Delivering value for money services.	The CIS will provide a sustainable revenue stream to the Council and support and enhance the delivery of frontline services.
A strong local economy – Making Huntingdonshire a better place to live, work and invest.	The CIS could be used to enable commercial development within the HDC area, attracting jobs and business growth.
Enabling sustainable growth – Delivering new and appropriate housing with minimum impact on our environment.	The CIS could be used to bring forward new residential development within the HDC area, including contributions to affordable housing provision.

<u>Criteria informing the CIS approach</u>

Feedback from key stakeholders, including the Overview & Scrutiny (Economic Well-being) Panel and Cabinet, showed a strong appetite for the CIS among both officers and Members. There was also agreement that the primary focus of the CIS is to be on commercial return, with an emphasis on revenue generation, with the need for this as identified in the "Plan on a Page".

The key criteria for investment options considered as part of this Strategy are listed in the following table and have been set to ensure that investments focus on commercial return. Criteria which need to apply to governance arrangements for the CIS are also set out below.

Criteria	Reason for criteria	Approach taken to inform CIS
Focus on revenue (rather than capital)	To meet revenue funding gap and enhance frontline services	- Acquire to hold, rather than to dispose - Re-invest any capital receipts - Potential to invest in existing property funds
Short term revenue generation	To meet short term funding requirements	- Seek to invest initially in current revenue generating assets or property funds - In the medium term, identify opportunities for greater return on investment by taking a longer term approach e.g. acquisition of vacant properties or development to realise a revenue stream
Ability to make timely decisions	The Council's current governance structure could impede the Council's ability to react quickly to investment opportunities	- Amendments to the levels of delegated decision making in the Constitution proposed and agreed through the Disposal and Acquisitions Policy
Managed risk	Benefits will need to be clearly evidenced in order to demonstrate value to stakeholders and the wider community	- Consideration for the type and amount of funding invested - Identify potential lower risk sources of revenue initially, moving to a more balanced risked portfolio

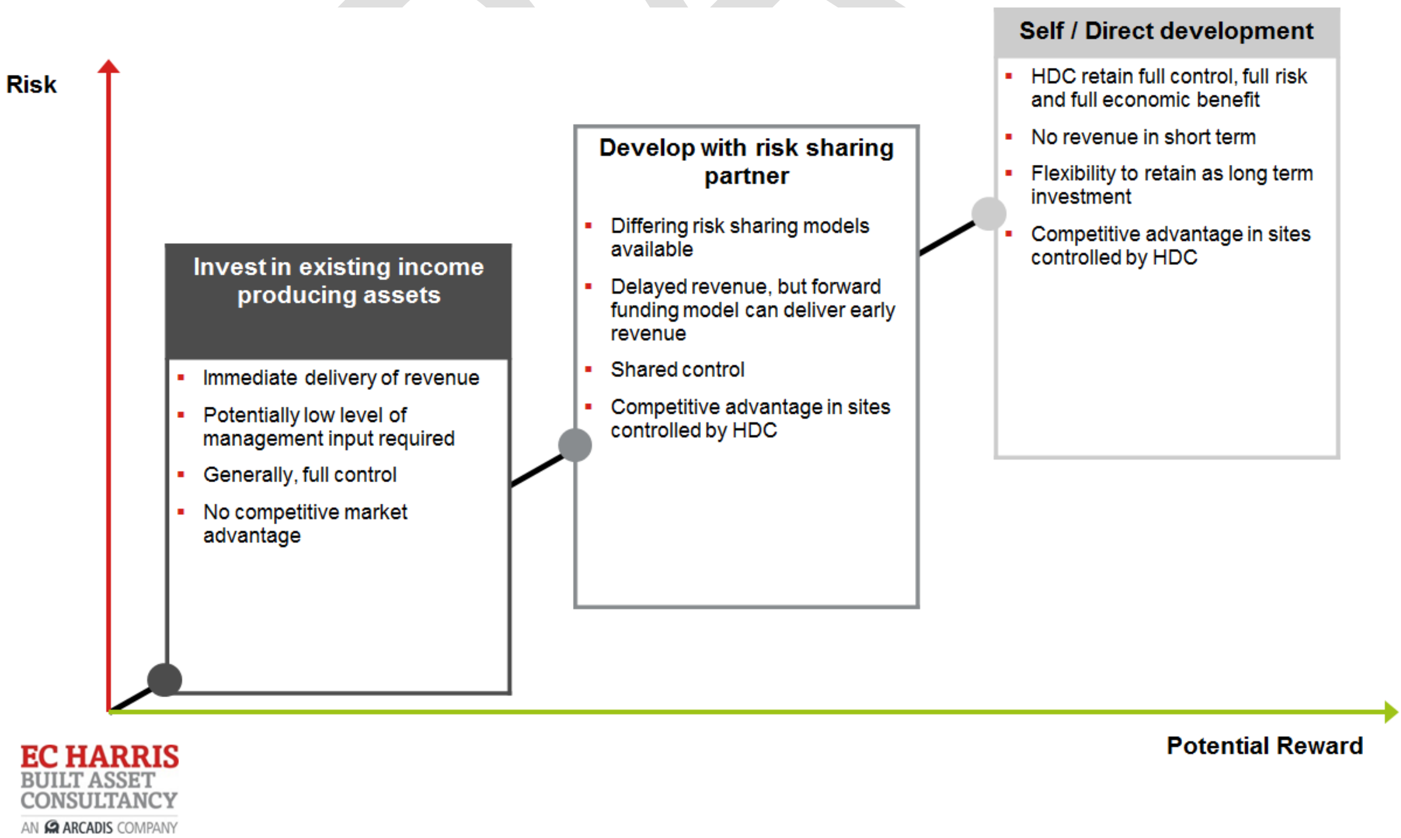
<u>Investment criteria</u>

Criteria	Reason for criteria	Approach taken to inform CIS
Control over investment decisions	It is important for the Council to control the nature of the investments to allow the opportunity to mitigate potential risks	- Indicates a preference towards direct investment (rather than investment into property funds) - If working with the private sector, preference is to have a controlling majority over decision making
Financial independence	Ensures the CIS is accountable and responsible for its performance, avoiding the need and temptation for cross-subsidy between the Council and the CIS	- Consider a governance structure where returns to the Council are through dividends - Capital receipts made within the CIS are ring-fenced and therefore can be reinvested back in the CIS
Stakeholder buy-in	Recognising that the CIS needs long term stability and cross political support to be successful	- Stakeholder consultation and engagement throughout the development of the CIS - Agreed and periodically reviewed business plan - Regular reports and reviews of CIS performance
Transparency	Meets the Council's audit and scrutiny requirements and demonstrates the basis of investment decisions and value for money	- Business cases required to support all investment decisions - Independent appraisal and evaluation - Regular reporting and review of CIS performance - Clear decision and management processes to be established

Criteria	Reason for criteria	Approach taken to inform CIS
Commercial and political sensitivity	Recognising that the set up and operation of the CIS may create conflicts of interest and as a public body reputational risks could impact upon the nature and type of investments	- Review governance structure for the CIS to mitigate any obvious conflicts of interest - Consider the reputational risks for the Council within any investment opportunities
Liquidity	To protect against market stress or changes to HDC strategy	- Some allocation to funds/shares which would allow HDC to access funds quickly
Not constrained by geography	Optimise the financial return with a greater number of opportunities	- Needs to balance with other strategic requirements such as control over investment decisions - Recognition that economic benefits to the area may not be optimised if outside the geographic area - May require additional market research to offset loss of competitive advantage and market knowledge from being outside the area

3. Investment Strategies and Delivery Options

There are a range of investment strategies with different financial, risk and timing profiles which have been considered. Each of these models could be used to deliver the CIS. The chart below shows the expected level of risk and reward associated with each of these.

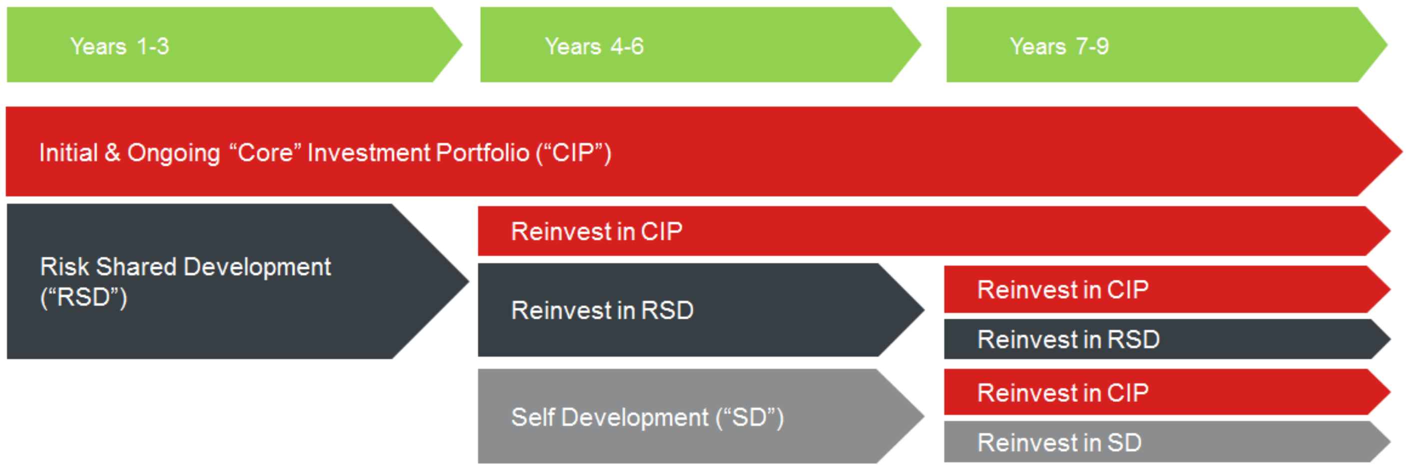


Seven delivery options are available for the Council to consider. The following diagram lists these in order of increasing risk and returns. Appendix 3 provides further detail on each delivery option.

Each option has benefits and limitations which can be assessed against the criteria in section 2 and the Council's key drivers.

4. Portfolio Model

In order to manage the portfolio in accordance with the criteria set out in section 2, it is proposed that a progressive approach to developing a portfolio model is taken. This measured model increases potential risk and reward over time, employing a blend of risk profiles with the proceeds of higher risk, shorter term activities partly redeployed back into the lower risk, long term sustainable "Core".



To ensure that the portfolio balances risk and reward, the CIS should be flexible enough to make use of all models and delivery options. The model above can take into account the following:

- The setting of overriding financial objectives and establishment of separate reporting for and analysis of the CIS
- Inclusion of the Council's existing commercial portfolio in the CIS
- The appropriate risk/return profile of the CIS
- The importance of income return in relation to the total return
- Use of borrowing to fund investment

To generate immediate income, initial investments will be focussed on the "Core" portfolio through delivery options 1-4. In developing the Business Plan, consideration will be given to investing in property funds and shares as the most liquid categories of delivery options. In this way, capital can be deployed in a timely and flexible manner. Such investments can be readily realised and redeployed.

The Business Plan will propose that higher value adding/risk investments are delayed until the CIS is embedded and appropriate resources are available to accommodate the additional preparation and management that such investments will require. Delivery options 5-7 should be focused initially within Huntingdonshire. The Council's knowledge of the district creates a competitive advantage and allows it to better manage risk and contribute to wider HDC objectives.

There may be some potential for added value to be achieved through CIS investments within the district, such as financial returns that could be achieved through the retention of NNDR income.

5. Governance

The governance structure for the CIS needs to allow the Council to trade on a commercial basis and also recognise the statutory and political boundaries that must be observed. The structure must be one that both Members and Officers will be comfortable with, two options are available to the Council and have been considered as follows:

- Option 1: Enhanced 'as is' position, expanded to include wider CIS activity. The Constitution has been amended to provide greater delegated decision making to allow Senior Officers and Members to act and take decisions on disposals and acquisitions of land and property. Such decisions will be taken within the parameters of a Business Plan to be approved by Cabinet.

- Option 2: Local Authority Trading Company (LATC). The Council could set up a LATC to deliver the CIS.

The Council's preferred option is **Option 1,** this makes use of existing resources, with our current commercial estate managed by the Estates team and run through the Council's main corporate governance channels. New financial thresholds for disposals and acquisitions of land and property are shown below. These were agreed as the previous thresholds were considered too restrictive to enable a more commercial approach to management of the Council's property portfolio. These will be reviewed 12 months after approval. The new Disposals and Acquisitions Policy sets out the legal context, principles and governance arrangements by which the Council will dispose of and acquire land and property.

Amount:	**Decisions on disposals and acquisitions of land and property delegated to:**
£0 - £500,000	Managing Director (as Head of Paid Service) & Head of Resources (as Section 151 Officer), following consultation with Executive Councillor for Resources
£500,000 - £2,000,000	Treasury and Capital Management Group
£2,000,000 +	Cabinet

Option 1 allows the Council to remain fully in control, with democratic processes to be followed involving Members in decisions. The Disposals and Acquisitions Policy states that the Council will have regard to all statutory and local regulations, including reporting to Corporate Management Team and in line with the Constitution, including the Treasury and Capital Management Group. All disposal and acquisition decisions will be retrospectively reported to the Overview & Scrutiny (Economic Well-Being) Panel.

This governance structure will ensure regular reporting to Members. An annual Business Plan will be presented to Cabinet for approval, with the Treasury and Capital Management Group to meet and receive reports on CIS performance on a regular basis. There will be a quarterly public report to Cabinet on CIS performance which will report against a range of metrics to be set out in the Business Plan.

6. Financial Modelling

The Business Plan will set out in detail the level and sources of funding to be invested in the CIS, the types of investment planned and timescales for these and the expected financial return from these investments. It will also identify potential investment opportunities.

The Council currently has a commercial estate consisting of over 200 assets valued at £20.8m. This estate generates £1.5m of net revenue, a return of 7.2%. This existing portfolio will be incorporated into the CIS and opportunities will be sought to sustain and improve net revenue. Potential development opportunities could generate capital receipts that could be used as a source of finance for the CIS to optimise and realised value, with a potential £1.2m in capital receipts estimated through a review of the commercial estate in 2012.

Opportunities to generate capital receipts for investment in the CIS may be identified through ongoing reviews of assets in the Council’s operational estate. Operational or community assets that become surplus to requirements due to estate rationalisation or adopting new ways of working could be disposed of or developed to generate CIS funds.

The CIS will also be funded through the use of Earmarked Reserves. The Capital Investment Earmarked Reserve currently has £4.737m available for early investment.

Further funding for investment could come from borrowing. With low interest rates available to the Council, the Business Plan will set out options for borrowing from lenders such as the Public Works Loans Board and investing the money in the CIS where net returns are expected to result in a profit for the Council. Borrowing can be increased over time if this remains affordable.

Additional revenue returns from investment in opportunities within the district may be possible. Investment in commercial property could generate additional NNDR, with a recent Government announcement to allow Cambridgeshire authorities to retain 100% of any additional business rate growth from April 2015.

The current and expected future profile of the CIS will be measured using a series of metrics, including:

- Historic and forecast income and total returns – at a property level and on an equity basis
- Benchmarking of returns (IPD – Investment Property Databank)
- Gross and net income
- Operating costs
- Total expense ratio (TER)
- Vacancy levels
- Tenant exposures
- Debt metrics (LTV – Loan to Value, ICR – Interest Coverage Ratio)

The current rate of return on the Council’s existing investment (9.4%) is considered to be above the market rate. The Business Plan will set out the expected rate of return from existing and new investments, taking into account changes in the property market and the wider economy.

7. Risk management

As described in section 2 and 4 above, a balanced approach will be taken to managing risks associated with the CIS. Initial investment will focus on lower risk investments, with potential risk and reward to be increased over time. A blend of risk profiles would see the proceeds of higher risk, shorter term activities partly redeployed back into the lower risk, long term sustainable “Core”.

It is acknowledged that the Council currently has limited resources and experience in property related investment and development so this approach to the CIS means the Council can take advantage of simpler investment opportunities at the outset. Capacity and capability can then be developed over time, with the Business Plan to set out where additional resources and support need to be brought in to guide investment decisions and monitor and manage performance.

Security over capital investment will be important, with Members recognising the need to protect the public purse. Parameters for the Loan to Value of each type of investment will be set out in the Business Plan. While property funds and shares are the simplest, most liquid investments, moving towards direct investment in land and property will provide security over physical assets. Diversification of the CIS portfolio through a series of investments over time should reduce the risk of the poor performance or the impact of a crash in the property market similar to the 2008 crash.

The Business Plan will set out risks and mitigation for the types of investments planned each year. The metrics set out in section 6 will allow performance and exposure to risk to be monitored and managed closely.

Appendix 1

Commercial Investment Strategy Business Plan

To be submitted for approval in October 2015