Item 5

NORTH YORKSHIRE COUNTY COUNCIL

CORPORATE AND PARTNERSHIPS OVERVIEW AND SCRUTINY COMMITTEE

7 December 2020

Alternative Investments – Year 3 Review

1. INTRODUCTION AND BACKGROUND

1.1 In August 2017 the Executive approved an alternative investment framework with £50m earmarked for longer term, more commercial investment. This was in response to the financial environment and low Bank Base Rate (BRR) which meant that the Council was and with the further cut in the bank rate, still is getting incredibly low returns on traditional investment of the Council's cash balances. In January 2019, following a review of the first year's activity, the overall sum available for investment was increased to £60m.

1.2 The approved strategic approach to managing cash resources was in accordance with the Council's Treasury Management Strategy and aimed to improve treasury returns, achieve revenue savings and potentially support the Council's wider objectives – for example driving additional income to support the Council's savings plans which in turn helps to ease pressure on front-line services.

1.3 The aim through this approach is to identify, assess and implement longer term (5 years plus) investment decisions including an element that targets commercial returns whilst ensuring the Council has access to sufficient cash to manage its day to day operations.

1.4 This report reviews the progress made over the last year, in the context of the global Coronavirus (Covid-19) pandemic. It identifies any lessons learned and the intended direction for the year ahead. Monitoring of the investments is incorporated into both the quarterly Capital Plan and Treasury Management reports to Executive.

2. OPTIONS CONSIDERED

2.1 The opportunities for investment fall into 3 broad categories:

- Internal Financing Adjustments – these opportunities are concerned with the use of resources within the Council, allowing resources to be earmarked or set aside to achieve revenue savings. They may not include the actual transfer of cash and as such can provide flexible opportunities.
- Alternative Treasury Management Instruments – these opportunities involve extension of the institutions and/or cash investment vehicles available to the Council through its traditional treasury management function.
- Alternative commercial investments – these opportunities are associated with the potential to invest in physical assets and projects delivered either directly by the Council or by/with partners in order to achieve a payback of the investment and an added return.

3. THE FRAMEWORK

3.1 The options available to the Council are varied and individual investments are subject to business case. However, limits on the sums invested and targets for investment returns ensure an appropriate balance between risk and reward, a diverse portfolio to help manage risk, and churn of cash to take advantage of future opportunities down the line.

3.2 The current approved high level decision framework comprises the following limits and target returns:

Type of investment	Risk	Maximum Exposure £000	Maximum Term Years	Target Rate (above BBR) %
Alternative treasury instruments - *note already covered in Treasury Strategy*	**Low**	**20,000 per category**	**1 - 5**	**> 0.1**
Alternative Investments (overall Max):		**60,000**		
Spend to Save	Low	5,000	7	4.0
Loans to Council Companies	Low - Medium	25,000	10	4.0
Loans to Housing Associations	Medium	10,000	20	3.0
Solar Farm (or similar)	Medium	5,000	20	7.0
Commercial Property	High	20,000	10	5.0

3.3 Consideration of individual investment opportunities are subject to detailed business cases with their risks and rewards assessed.

3.4 Given the technical nature of such investments and strong linkages to the Council's Treasury Management function, appropriate governance and decision making arrangements are needed to ensure robust due diligence and the necessary agility to act. The Commercial Investment Board considers the identified opportunities and oversees the arrangements.

3.5 The Executive delegated authority to enter into individual investments up to £2.5m within an overall total of £10m p.a. The Board's approved terms of reference are attached at **Appendix A**.

3.6 The Board meet routinely every 2 months but more frequently when opportunities are actively being considered. This flexible approach enables a degree of agility for lower value opportunities, with investments in excess of £2.5m requiring Executive approval and therefore a longer lead in time.

4. YEAR 3 –REVIEW

4.1 The investment framework approved by the Executive identifies a range of potential investment options:

Alternative Treasury Management Instruments

4.2 A number of alternative instruments are potentially available to the Council – some already covered by the approved Treasury Management Strategy but not yet used. Typically, higher credited rated instruments offer lower rates of return and therefore some of these types of investment have limited impact on overall returns. However, they do provide alternatives to the investment we currently use and as such allow us to diversify our portfolio. Options currently used are:

i) Money Market Funds
ii) Certificates of Deposit (CDs)
iii) Property Funds

4.3 A review of the Council's Treasury Management Strategy was undertaken in 2017/18 and a £20m limit was included for these opportunities. The infrastructure for the alternative investment options identified is now in place.

4.4 Money Market Funds

Following a selection process supported by the Councils Treasury Management advisers the following Money Market Funds were selected for investment:

- BlackRock Money Market Fund
- State Street Global GBP Liquidity Fund

4.5 Accounts have been opened with both funds and investment opportunities are continually monitored against other Treasury Management investment options. Money Market Fund investments are highly liquid with daily access to funds available – an average balance of £20.0m at 0.1% has been invested in funds up to 30 September 2020. Whilst only equivalent to bank rate at 0.1%, these funds provide flexibility and useful access to cash.

4.6 Certificates of Deposit (CDs)

The Council has now established a custodian account to enable investment in a wider range of treasury instruments, including Certificates of Deposit (CDs). In 2018/19 the Council invested in Nat West Bank (£5m) and Credit et Industriel Bank (£5m). Both of these investments matured in early 2019. While further potential investments continue to be monitored, rates available with approved institutions have not been competitive.

4.7 Property Funds

A detailed selection process was undertaken in 2018/19, supported by the County Councils Treasury Management advisers and, two Property Funds were selected for investment:

- BlackRock UK Property Fund
- Threadneedle Property Unit Trust

4.8 Accounts were opened with both funds and a £3m investment in each fund was agreed with transactions completed at the end of October 2018. In the first year, the funds provided a good revenue returns but returns have fallen because of the global pandemic. For the first ½ year of 20/21, average returns have been 3.8% compared to 3.9% in 2019/20, well in excess of the returns achieved on our traditional treasury investments.

4.9 As reported previously, given the on-going wider economic and political uncertainty, capital losses and impacts on revenue returns are expected in the shorter term and these funds are monitored closely. The pandemic has undoubtedly impacted on capital values, with both funds experiencing further losses over the first half of 20/21 - £168.2k compared to - £67k in 2019/20 and £41k in 2018/19.

4.10 The uncertainty in financial markets following the first national Covid-19 lockdown led to widespread suspension of trading in a number of property funds. Both of the funds that the Council has invested in suspended trading in March 2020 and subsequently reopened in October 2020.

4.11 Both funds' strategies for dealing with the kinds of economic shocks being experienced now, are under review but it is stressed that property funds are long term investments and valuations can, therefore, rise and fall, over the period they are held. Any gains or losses in the capital value of investments are held in an unusable reserve on the balance sheet and do not impact on the General Fund until units in the funds are sold.

Alternative Commercial Investments

4.12 Loans to Council Companies
The Council currently owns (in whole or part) a number of companies which have been established to deliver a variety of objectives. The Council provides cash flow support to these companies and has £22.3m loans (at 30 September 2020) on its balance sheet at a variety of terms (duration and interest rates).

4.13 Given the nature of the companies and the Council's direct involvement in their operation, relative to other types of investment these are considered lower risk and are currently offered at a rate of bank base rate plus 4%. A review of rates has been undertaken which will increase the rates charged but implementation has been delayed as a result of the pandemic. This position will be reviewed at the end of 20/21.

4.14 Loans are classed as capital expenditure and financed through internal borrowing in accordance with the Council's Treasury Management Strategy. Current Loans to Limited Companies as of 30 September 2020 were:

Company Loan	Total Loan Approved £k	Interest Rate %	First Drawdown Date	Total Loan 30/09/2020 £k	F'cast Int 2020/21 £k
NYNet*	10,000	Base + 3.0	01/04/2006	11,243	250
Yorwaste I	3,700	Base + 4.0	23/05/2012	3,700	150
Yorwaste II	3,850	Base + 4.0	19/06/2017	2,721	120
Brierley Homes	25,000	Base + 6.5	12/05/2017	4,557	150
Align Property Partners	500	Base + 4.0	N/A	0	0
First North Law	250	Base + 4.0	09/05/2017	90	10
NY Highway**	11,000	Base + 6.5	N/A	0	90
	54,300			**22,311**	**770**

* The NYNet Loan is an overdraft facility.
**1st drawdown of £50k made 22/10/2020

4.15 As shown in the table above, there is an increasing demand for loans from the Councils limited companies and lending limits will be kept under review.

Commercial Property

4.16 Direct investment in commercial property can be aligned to the Council's Economic Development Strategy and/or can be undertaken on a purely commercial basis. Returns can vary significantly and each opportunity has to be considered on its merits having due regard to risk and reward. To date the Council has shortlisted 52 potential property investments; taken 18 to business case stage; six bids have been formally submitted; and three of these properties have been successfully acquired. No further acquisitions have been made in the last year. Net returns of £173k are forecast for 2020/21.

4.17 Details of property investments to date are as follows:

Bank Unit in Stafford Town Centre
The acquisition of a freehold bank unit and lease in Stafford Town Centre, Staffordshire. The property is currently let to Bank of Scotland plc trading as Halifax and is held on a lease that runs to November 2031. There are no issues of concern to report.

Harrogate Royal Baths
The acquisition of a leasehold restaurant / leisure investment in Harrogate Town Centre. The property comprises of four commercial units - three units are currently let with expiry periods ranging from 2027 – 2038. One unit was vacated in early 2019 after the tenant entered administration. Negotiations with a prospective tenant are currently in progress and subject to some repair works, which will fall to the County Council. The pandemic has had a significant impact on the businesses operating from the premises with the night club, bar and restaurant all closed for extended periods over the year to date. Rent

deferrals have been agreed where considered appropriate and we are supporting our tenants as much as we can in the hope that they remain viable into the future.

Co-op Store
The acquisition of a freehold retail unit and lease in North Somercotes, Lincolnshire. The property is currently let to Co-Operative Group Food Limited on a 15 year lease that runs to 20 September 2033. There are no issues of concern to report.

5. ESTIMATED RETURNS

5.1 A summary of the estimated returns from the investments made to date are shown at **Appendix B.** In total MRP savings of £600k p.a. have been achieved, returns on treasury investments are estimated to be £223k and returns on the alternative investments in place are estimated at £943k p.a. The total projected annual gross income/savings generated from the alternative investments to date is £1,766k – this is a margin of £1,616k over traditional treasury management returns.

5.2 The report which set out the proposed framework indicated that annual revenue savings/returns of in excess of £1,700k could be reasonably achieved (subject to projects being identified and approval of business cases).

5.3 A 2% top-slice of the additional returns contribute to the Finance savings programme - which based on returns of £1,616k estimated to date, would result in a top-slice of £32k. This will be kept under review as further investments are made.

5.4 Estimated capital losses of £1,976k have occurred to date. Although these will potentially not be realised until the investments are sold, provision has been made should these ultimately be sustained. To date £2,200k has been set aside in an earmarked reserve to mitigate this future risk and a further £1,700k is planned for set aside in 20/21. This represents circa 10% of the value of property related investments made to date. Should values recover prior to sale then these funds can be released for alternative use.

6. LESSONS LEARNED

6.1 Whilst significant returns are expected from these investments, the resource input required from within and external to the Council is significant. Each proposition requires careful assessment of the market, the legal issues, and the risks and the returns expected in order to inform a robust business case.

6.2 The competitive nature of the market for these investments means that a degree of failure to secure investments is to be expected and indeed some business casework will be abortive as some investments will not be considered appropriate for investment. Where possible early sifting of proposals aims to focus efforts on opportunities worth pursuing but inevitably not all business cases will result in a successful acquisition.

6.3 Appropriate due diligence is crucial in order to take decisions for investment and it is important that timely expert advice is sought when necessary, in order to adequately assess the potential risks and rewards from such opportunities.

6.4 Commercial asset ownership brings landlord responsibilities and whilst where possible and appropriate, managing agents will be used, there is an overhead which cannot be outsourced and the capacity in this areas needs careful monitoring to ensure sufficient oversight is maintained and any costs arising from vacant units are recognised and managed.

6.5 2020 has been a challenging for commercial investment as the impacts of the global pandemic have and continue to unfold. High profile business failures and changes to remote/homeworking is likely to change the way a number of sectors do business into the future and this will inevitably impact on the demand for and value of commercial property. Provision for capital losses has been made within the Council's budget as part of our response to the virus. Understanding the trajectory of market changes and flexibility/redevelopment potential of future acquisitions will be key.

7. NEXT STEPS

7.1 Commercial Property

During the current pandemic no further acquisitions are being pursued but the markets will continue to be monitored and should opportunities arise they will be considered when the time is considered appropriate.

7.2 Solar Farm (or similar)

Work is progressing on a potential solar farm investment with market engagement for a 'turnkey' project with a development and operating partner about to begin. This is a rapidly expanding industry and the country's first two subsidy free solar farms are now in operation.

7.3 Loans

The Council's commercial agenda, provides opportunities for extending the level and number of loans to NYCC's growing portfolio of companies. We will continue to support this agenda and keep lending limits and rates under review.

7.4 Debt Repayment

The Council currently has external borrowing of £263.1m as at 30 September 2020 with varying terms and interest rates. Repayment of borrowing would reduce the Council's Capital Financing Requirement and hence it's MRP charge and would save external interest payments however there may be penalties for loans repaid early.

7.5 Link, the Council's treasury management advisors regularly review the Council's debt portfolio and current interest rates and future forecasts suggest that it is not beneficial to repay debt at this time as there would be little opportunity for early repayment without the Council incurring substantial premium charges. This will continue to be monitored as part of the Council's on-going treasury management activity.

8. CONCLUSIONS

8.1 The global pandemic has significantly impacted activities and returns on alternative investments although together this approach has secured estimated annual revenue savings/income of £1,766k a margin of £1,616k over traditional treasury management returns.

8.2 Capital losses have occurred over the last year and although these will not be realised until the investments are sold, provision has been made should these ultimately be sustained.

8.3 Caution will be exercised over future investments given the economic climate. Further work to pursue potential investment in solar energy is in progress and a business case will be brought forward for consideration/approval in due course.

9. RECOMMENDATION

9.1 It is recommended that Overview and Scrutiny Committee reviews the progress to date and provide comments on the future actions proposed.

APPENDIX A

Commercial Investment Board

Purpose

The Board will not be a constituted body and will therefore not have formal decision making powers. However, it will be the chief means of identifying, reviewing and recommending schemes for investment decisions. Such formal decisions will be taken within the existing delegations namely through delegated authority to the Corporate Director, Strategic Resources and further decisions as made by the Executive.

To consider and recommend detailed business cases for alternative investments within the framework approved by Executive.

To approve individual investments to a limit of £2.5m per investment and up to a total of £10m in any one financial year.

To consider appropriate due diligence proportionate to the investment/risk/reward proposed.

Notwithstanding the Corporate Director, Strategic Resources authority to terminate investments should concerns be raised - to consider and recommend cases for early termination of alternative investments.

To monitor returns against approved performance targets.

To report performance of alternative investments to the Executive on a quarterly basis

To make recommendations to Executive on any proposed changes to the framework.

Membership

Lead Member for Finance (Chair)

Lead Member for Growth

Corporate Director Strategic Resources

Corporate Director Business and Environmental Services

Assistant Director Strategic Resources – LBP to CFO

Assistant Director BES - Growth, Planning and Trading Standards

Frequency of Meetings

Board meetings likely to be held quarterly however the nature of investment opportunities will require agility and meetings will be arranged as required outside of the quarterly schedule.

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Updated January 2019

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APPENDIX B

Investment/Returns at 30 September 2020

Alternative Investment Options	Max Exposure	Actual Investment	Actual rate of return To Q2 %	Term	Actual / Forecast Yield/ Saving p.a. £	Comments/Notes
Additional MRP (non-cash movement)	**N/A**	**15,000**	**4%**	**N/A**	**600**	
Treasury instruments	**£20m per category**			**5 years max**		
Property Funds		5,930	3.78%	5 -10 years	208	Forecast 3.5% average revenue return for 20/21
Certificates of Deposit		0	0	N/A	0	No investments currently in place
Money Market Funds		20,000	0.1%	Instant Access	15	
		25,930	**0.86%**		**223**	
Alternative Investments	**£60m max**			**Various**		
Spend to Save	5,000			7 years max		
Loans to LA owned companies	25,000	22,311	3.60%	Various	770	Balance and Forecast Return as at 30/09/20
Commercial property investment	20,000	11,877	1.46%	10 years max	173	Rental income net of landlord costs
Loans to housing associations	10,000	0	N/A	N/A	0	
Solar Farm or similar	5,000	0		30 years max	0	
Total Alternative Investments (subject to risk appetite)		**34,188**	**2.65%**		**943**	
Total annual saving/income		**75,118**	**2.30%**		**1,766**	
Treasury Management Return			0.25%		150	
Total annual margin over standard returns			**2.05%**		**1,616**	