

NORTH YORKSHIRE COUNTY COUNCIL
CORPORATE AND PARTNERSHIPS OVERVIEW AND SCRUTINY COMMITTEE

6 December 2021

Alternative Investments – Year 4 Review

1. INTRODUCTION AND BACKGROUND

- 1.1 In August 2017 the Executive approved an alternative investment framework (see Appendices A & B), 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 and changes to rules around borrowing for commercial purposes following some high profile business failures in local authority backed ventures.
- 1.5 Monitoring of the investments is incorporated into both the quarterly Capital Plan and Treasury Management reports to Executive.

2. YEAR 4 –REVIEW

- 2.1 The investment framework approved by the Executive (as shown in Appendix A) identifies a range of potential investment options:

Alternative Treasury Management Instruments

- 2.2 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
- 2.3 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.

2.4 Money Market Funds

As at 30th September 2021 there are no sums investment in Money Market Funds.

2.5 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. There are no sums invested in Certificates of Deposit as at 30th September 2021.

2.6 Property Funds

A detailed selection process was undertaken in 2018/19, supported by the County Council's Treasury Management advisers and two Property Funds were selected for investment - BlackRock UK Property Fund, and Threadneedle Property Unit Trust. Accounts were opened with both funds and a £3m investment in each fund was agreed with transactions completed at the end of October 2018.

2.7 In the first year the funds provided a good revenue returns but returns have fallen as a result of the global pandemic. For the first half year of 21/22 average returns have been 3.46% compared to 3.43% in 20/21 and 3.9% in 2019/20, well in excess of the returns achieved on our traditional treasury investments.

2.8 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 to the end of 20/21 - £349.1k, however values have started to recover in 21/22 with increases of £332.5k (6%) experienced to 30th September 2021.

2.9 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 no further suspensions have been required.

2.10 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

2.11 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 £19.6m loans (at 30 September 2021) on its balance sheet at a variety of terms (duration and interest rates).

2.12 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 but are currently offered at a rate of bank base rate plus 4% - 6.5%. Rates are kept under review.

2.13 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 at 30 September 2021 are:

Company Loan	Total Loan Approved £m	Interest Rate %	Loans 30/09/2021 £m	F'cast Int 2021/22 £k
Yorwaste		Base + 4.0	6.0	251.0
Brierley Homes		Base + 6.0	11.3	704.0
First North Law		Base + 4.0	0.1	3.7
NY Highway**		Base + 6.5	2.2	357.0
	25.0	Average 5.53	19.6	1,315.7

- 2.14 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.
- 2.15 Commercial Property
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 revenue returns of £282k (2.38%) are estimated for 2021/22 although notional losses in capital values total £2.8m. Details of property investments to date are as follows:
- 2.16 **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.
- 2.17 **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. 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 last 2 years. Rent deferrals have been agreed where considered appropriate but the longer term viability of some tenants is a concern.
- 2.18 Unsurprisingly we have experienced capital losses on this asset and provisions have been made. Councillors should note that property investments are intended to be long term and changes in valuations, up and down, can be expected, although the issues associated with Covid and the resulting lockdowns could not have been foreseen. The Council has been able to mitigate these issues but officers are working closely with tenants to achieve a return to pre-Covid performance as soon as is practicably possible.
- 2.19 **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.
- 2.20 Commercial Solar Energy Generation
In 2021/22 work commenced on a potential solar farm investment with market engagement for a 'turnkey' project. The aim was to identify a 'shovel ready (or near ready) site with a development and operating partner in place. The market engagement exercise highlighted the competitive nature of such investments, with those that showed the most promising returns already having investors in place.
- 2.21 The exercise identified 2 potential opportunities but with capital investment in excess of £40m these opportunities were outside the Council's agreed framework and given the

inherent risks with such a project (such as up-front investment with up to 40 year payback being subject to future price and market volatility) considered too high to take forward.

- 2.22 Whilst there were other smaller opportunities available there were none that achieved the Council's required return and therefore none were recommended. The exercise concluded that in order to achieve the returns expected, large scale investment would be needed. In addition recent volatility in the energy market and the folding of a number smaller energy companies, further emphasised the inherent risk within the energy market at this time.
- 2.23 The exercise also confirmed that none of the Council's existing available land holdings were suitable for commercially viable solar investment but opportunities to support the Council's climate change agenda could be pursued. The output of this work has been passed to the Climate Change group for consideration.
- 2.24 Looking ahead, whilst no suitable investments were identified, discussions with a number of like-minded authorities have been initiated and the potential for future joint investment will be explored.

3. ESTIMATED RETURNS

- 3.1 A summary of the estimated returns from the investments made as at Q2 21/22 is shown at Appendix C. In total MRP savings of £600k p.a. have been achieved, returns on treasury investments are estimated to be £200k and returns on the alternative investments in place are estimated at £1,597k p.a.
- 3.2 The Q2 treasury Management report shows standard treasury returns of 0.19% for the first half of 21/22. Alternative investment achieved a net return of 4.58%. The total projected annual gross income/savings generated from the alternative investments to date is £2,397k – this is a margin of £2,298k over traditional treasury management returns.
- 3.3 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).
- 3.4 A 2% top-slice of the additional returns contribute to the Finance savings programme - which based on returns of £2,298k estimated to date, would result in a top-slice of £46k. This will be kept under review as further investments are made.
- 3.5 Estimated capital losses of £2,814k 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 £4,250k has been set aside in an earmarked reserve to mitigate this future risk. 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.
- 3.6 The value of Commercial Property investments will continue to be assessed as markets recover from the impact of Covid-19. Commercial Property is a long term investment and valuations can, therefore, rise as well as fall, over the period they are held. In order to mitigate any potential future loss funds will be set aside to ensure that there is no impact on the General Fund at the point of any future sale.
- 3.7 The County Council continues to review potential commercial investments, but will now consider any potential investment opportunities alongside the implications for PWLB borrowing going forward, however, the 2021/22 Capital Plan does not include any plans to purchase commercial assets primarily for yield.

4. LESSONS LEARNED

- 4.1 The impact of Covid and other economic related issues on the commercial property market (and other commercial activities) has been profound and there have been some high profile failures over the last two years.
- 4.2 The Government and CIPFA have expressed their concerns over some authorities' aggressive commercialisation strategies as their exposure to commercial market risk has expanded leaving them vulnerable to significant losses and ultimate Government intervention.
- 4.3 North Yorkshire County Council's approach is measured and modest with the amount made available for investment proportionate to the risks involved and directly supported by a robust assessment of long term cash availability rather than being fuelled by borrowing. The Council has no plans to borrow primarily for yield, which is not permitted under the new rules. The rules also restrict access to PWLB borrowing for other purposes for a period of 3 years, even if borrowing is not related to such investment.
- 4.4 Given the current risk within the market, plans for further investment have been suspended and no new investments are included in the Capital Plan for the foreseeable future.
- 4.5 Going forward, the Council will review potential commercial investments which are aligned to policy objectives, and will consider any potential investment opportunities alongside the implications for PWLB borrowing.

5. CONCLUSIONS

- 5.1 The global pandemic has significantly impacted activities and returns on alternative investments although together this approach has secured estimated annual revenue savings/income of £2,397k a margin of £2,298k over traditional treasury management returns.
- 5.2 Capital losses have occurred and although these will not be realised until the investments are sold, provision has been made should these ultimately be sustained.
- 5.3 Caution will be exercised over future investments given the economic climate. No further investments are included in the Capital Plan at this time but future opportunities will be considered in the context of policy objectives.

6. RECOMMENDATION

- 6.1 The Overview and Scrutiny Committee is asked to review the progress to date.

Karen Iveson
Assistant Director, Strategic Resources

25 November 2021

Appendix A – Alternative Investment Framework
Appendix B - Commercial Investment Board Terms of Reference
Appendix C - Estimated returns from the investments made as at Q2 21/22

The Framework

- 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.
- 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 - <i>note already covered in Treasury Strategy</i>	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 Consideration of individual investment opportunities are subject to detailed business cases with their risks and rewards assessed.
- 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.
- 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 B**.
- 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.

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.

Approved 15 August 2017

Updated January 2019

Investment/Returns at 30 September 2021

Alternative Investment Options	Max Exposure	Actual Investment £m	Actual rate of return To Q2 %	Term	Actual/Forecast Yield/ Saving p.a. £	Comments/Notes
Additional MRP (non-cash movement)	N/A	15.0	4%	N/A	600	
Treasury instruments	£20m per category			5 years max		
Property Funds		5.9	3.46%	5 -10 years	200	Forecast 3.3% average revenue return for 21/22
Certificates of Deposit		0	N/A	N/A	0	No investments currently in place
Money Market Funds		0	0.0%	Instant Access	0	
		5.9	3.46%		200	
Alternative Investments	£60m max			Various		
Spend to Save	5,000			7 years max		
Loans to LA owned companies	25,000	19.6	5.53%	Various	1,315	Balance and Forecast Return as at 30/09/21
Commercial property investment	20,000	11.9	2.38%	10 years max	282	Rental income net of landlord costs (Valuation @ 31/3/21 £9.08m)
Loans to housing associations	10,000	0	N/A	N/A	0	
Solar Farm or similar	5,000	0	N/A	30 years max	0	
Total Alternative Investments (subject to risk appetite)		31.5	4.34%		1,597	
Total		52.4	4.58%		2,397	
Treasury Management Return			0.19%		99	
Total annual margin over standard returns			4.39%		2,298	