

<b>SUBJECT:</b>	<b>Asset Management Strategy update – Commercial Investments</b>
<b>MEETING:</b>	<b>County Council</b>
<b>DATE:</b>	
<b>DIVISION/WARDS AFFECTED:</b>	<b>All</b>

**1. PURPOSE:**

To explore the definition of commercial investments and obtain approval to supplement traditional “bricks and mortar” acquisitions with consideration of other prudent and sensible investment types.

**2. RECOMMENDATIONS:**

2.1 To approve a widened definition of Commercial Investment that allows Investment Committee to consider opportunities that meet return expectations not simply limited to land and building acquisitions.

2.2 So it would be appreciated if Members could consider each bullet point separately with regard to whether it wishes to extend the definition to

- Allow consideration of commercial loan facilities
- Allow consideration to use investment budget to build or renovate investment portfolio holdings
- Allows consideration of an equity or debenture interest

**3. BACKGROUND:**

3.1 Full Council, in agreeing the Asset Management Strategy on 10<sup>th</sup> May 2018, approved the following in respect of Commercial Investment,

- To agree to the adoption of the Asset Investment Policy and the approval of up to £50,000,000 of prudential borrowing to fund acquisitions over a three year period.
- The delegation of authority to an Investment Committee to approval Business Cases and agree to the acquisition of land and property assets in line with agreed evaluation criteria and subject to annual performance reviews.

3.2 The Investment Committee mechanism agreed by Members at full Council effectively gives Investment Committee a delegation to manage a £50m investment portfolio, appreciating that this would allow Members to pragmatically consider individual proposals involving commercially sensitive information in a time sensitive manner.

3.3 In practice the volume of suitable proposals considered by investment Committee remains fairly restricted, because realistic opportunities are limited when compared against a test of suitability and risk appetite. To date the Investment Committee has prudently only taken forward the acquisition of Castlegate Business Park, as it derived a sufficient return after repaying borrowing costs. The revenue stream involves the sublet of the building to tenant businesses, primarily Mitel.

#### 4 KEY ISSUES

4.1 Council colleagues have remained conscious of the commercial investments aspirations within Monmouthshire, also appreciating that draft 2019-20 budget proposals include a £570k income generation motivation. As a result they have received a couple of proposals that interpretively wouldn't fit within a simple "land and property" assets definition, being more financial assets, yet would meet Council net return criteria whilst also having the advantage of facilitating business growth within the locality.

4.2 There is an incongruence to manage in trying to give Members enough in principle information on which to form an opinion whether to extend commercial investment consideration beyond simplistic land and buildings needing to be balanced against the commercial nature of such proposals and the likelihood of being outbid/upstaged if greater detail were put in a public forum at this stage.

So in summary examples of situations where a widening of commercial investment definition is requested, include,

- Short term (5-10 year window) fully repayable loan to a company providing communication infrastructure within Monmouthshire for the benefit of businesses and residents. On loan based investments, the essence of proposals effectively utilises the differential between borrowing rates available to local authorities and the repayment made by the business concerned at a demonstrable commercial rate. Councils traditionally already have the ability to stimulate economic growth under their economic development powers, however it is felt more appropriate to consider things like state aid consideration and the business case for such an investment under the Investment Committee of the Council as the investment is discretionary rather than statutory in nature. By way of explanation, **State aid** is to be avoided, and is regarded as any advantage granted by public authorities through **state** resources on a selective basis to any organisations that could potentially distort competition and trade in the European Union (EU). The charging of market loan rates (so rates available elsewhere), more easily allows any local authority to transparently demonstrate its actions neutral to issues of competition.
- Using the investment fund to build upon land either owned or acquired (through the investment fund) by Council to either achieve sufficient anticipated return in the form of capital appreciation from subsequent sale, or an improved annualised rental stream. The risk associated with progressing a significant build element, is around the ability to service the borrowing costs initially as there would be no obvious revenue until the asset is completed and utilised or sold. Longer term that wouldn't be so much of an issue, in being able to utilise other commercial investment returns, similar to how holistic treasury management works.

- Consider an equity (shareholder) or debenture (creditor) interest in a business sector start up company to promote inward sector growth, with dividends forming the return on investment.

- 4.3 At present, officers would pass up the opportunity to present such proposals for formal consideration by Investment Committee's, despite the benefits perceived to Monmouthshire residents and returns anticipated.
- 4.4 If useful background, proposals presented to Investment Committee seek to describe the opportunity being considered from the perspective of the cashflows anticipated, and net returns quantified, any qualitative benefits evaluated, reasonableness of assumptions made, any risks/volatility anticipated against those assumptions, and provides the risk mitigation action proposed should those risks crystallise. There is a skewed emphasis towards the risk mitigation aspect of any proposal, not because highly speculative opportunities are being presented to investment committee, but instead recognising that any investment has a degree of speculation and despite commercial investment being an increasingly common aspect for local authorities to address declining central government resourcing, the stewardship of public funds and security of investment remains a key consideration to any local authority decision making.
- 4.5 The scrutiny mechanism assigned to review the Commercial Investments sub committee will be the Audit Committee, it will receive an annual report concerning activity and performance.
- 4.6 In considering the legal arrangements around the powers to undertake commercial investments. Council did receive the following external legal advice to the effect that,
- *Section 120 of the Local Government Act 1972 provides powers to enable land acquisition for the purposes of investment. This includes investments outside of a local authority's area.*
  - *Section 1 of the Local Government Act 2003 provides powers for borrowing of funds to achieve investments.*

*Lawyers report that "whilst traditionally both powers have been narrowly interpreted, in recent years the direction of travel has been to adopt a wider interpretation in order to encourage innovation. England benefits from a general power of competence. This power in England has resulted in a number of local authorities investing in property portfolios, generating income to supplement budgets (see Mansfield District Council, Spelthorne District Council, Sevenoaks District Council, and Southampton City Council). The Welsh Government has a stated intention to introduce such powers in Wales. This supports a contention that the general direction of travel in Wales is towards a wider interpretation of the powers available."*

*They conclude "The use of existing powers is however not without risk. Case law suggests that challenges are likely to come when investments perform poorly, rather than in a rising market. There is of course a risk that investments do not yield any income but require expenditure (e.g. at times of economic recession). Such circumstances may encourage courts to revert to a more traditional and narrow interpretation of local authority powers. Such economic circumstances are likely to increase levels of public scrutiny. It is extremely important that the Local Authority is able*

*to demonstrate that investments are prudent and reasonable, based on sound decision making and that they are well managed.*

*Experience of English councils would suggest there is a relatively low risk of challenge from disgruntled private sector competitors to local authority activity in this area. We are not aware of any such reports in England to date.*

- 4.7 The widening definition of commercial assets can be read as consistent with that legal advice, although it appreciated that when advice was sought, it wouldn't have explicitly covered such proposals.
- 4.8 Details of investment committee activities have been shared with WAO colleagues previously, as part of periodic briefing to explain new aspects or significant new considerations. To date their approach not to provide any feedback, recognising to do so, potentially fetters their independence when it comes to their Statement of Account considerations.
- 4.9 The main change in emphasis in considering financial type assets, is that the consideration and risk mitigation would tend to be more contractually and legally secured recognising the Council would not have a tangible asset that it can influence or realise as with traditional bricks and mortar investment.

In a traditional bricks and mortar consideration for instance, the risks associated with rent loss (void levels) being different than assumed, can reasonably be mitigated through the sale, remodelling or reletting of the asset as the Council has bought a tangible asset.

Interestingly despite this, financial investments can actually provide less risk in reality than property investment, as the Council avoids the liabilities commonly associated with asset ownership, and is more removed from the nuances/volatility of the property market. It can also be the case that returns on investments can be realised more quickly in the form of short to medium term loan repayments, and at a higher return rate than that commonly available with property which tends to be a more long term consideration, and that longer term nature with respect to property ownership increases the probability of subsequent market reality being different than initial business plan assumptions.

- 4.10 No consideration of investment would be complete without reflection upon Brexit and its effect on commercial investment proposals. It is very difficult to get any professional immutable view on the consequences to Brexit or the effect on particular businesses, and whether it's a sensible time or otherwise to undertake particular commercial investments. However members can draw some comfort that there is some similarity in the disciplines attached to commercial investment consideration and our more commonplace cashflow and treasury considerations, in that both ought to consider security, liquidity and yield of prospective investment.

Similarly if helpful, the Council's treasury advisors, in providing advice on our lending and borrowing portfolio in the current uncertain climate, is that it remains sensible to seek diversity and derive a blended portfolio of fixed and variable interest rates, using both short term and longer term instruments, to mitigate market conditions and avoid putting too great

an emphasis on any one product/sector. The discipline regarding commercial investments needs to be similar to Treasury investment considerations, in that any evaluation needs to have regard for the “SLY” principles in prioritising consideration of Security, Liquidity and Yield. So this advice would seem sensible to also consider in relation to commercial investments, in that it is more prudent to derive a mixture of investment opportunities rather than being solely reliant on acquisitions of office or retail land and buildings appreciating other assets likely to derive shorter term higher rate returns, or that flexibility to allow for build/betterment works has the potential to generate greater capital appreciation or more sustainable revenue rentals.

- 4.11 The differing nature of these investment proposals would still necessitate the same robust business case as traditional prebuilt bricks and mortar acquisitions to satisfy the existing rate of return tests i.e. minimum 2% above borrowing costs and 7% target rate of return per annum. The immutable consideration being a demonstrable surplus after financing and any operating costs.

## **5. REASONS**

- 5.1 This report seeks to obtain the full Council's view whether it would be sensible to extend the definition of investment into non tangible assets as indicated, in order to diversify the commercial investments portfolio and be able to consider other opportunities that meet financial benefits tests.

## **6. RESOURCE IMPLICATIONS:**

- 6.1 The effect of a widened consideration would increase the number of proposals available for consideration by Investment committee.
- 6.2 Such decisions still needing to meet the existing tests of consideration and afforded within the existing £50m approval by full Council.

## **7. WELLBEING OF FUTURE GENERATIONS IMPLICATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING):**

- 7.1 There are no identified negative impacts arising, a widened volume of proposal opportunities may allow net revenue returns to further support Council's core activities appreciating that 2019-20 draft budget proposals recognises a need to derive £400k net income from its commercial investment returns.
- 7.2 This report is not anticipated to have any direct safeguarding or corporate parenting implications.

## **8. CONSULTEES:**

SLT  
Cabinet  
Head of Legal Services

Chief Officer for Resources

**9. BACKGROUND PAPERS:**

None

**9. AUTHOR:** Mark Howcroft                      Assistant Head of Finance

**10. CONTACT DETAILS:**

**Tel:** 01633 644740

**E-mail:** [markhowcroft@monmouthshire.gov.uk](mailto:markhowcroft@monmouthshire.gov.uk)

