monmouthshire
sir fynwy

SUBJECT:	**Investment Committee Performance Review**
MEETING:	**Audit Committee**
DATE:	**25th March 2021**
DIVISION/WARDS AFFECTED: All	

1. PURPOSE:

To provide members of the Audit Committee the second performance review of the Investment Committee for consideration in accordance with the requirements of the Asset Investment Policy.

2. RECOMMENDATIONS:

2.1 For the Audit Committee to consider and scrutinise the second performance review of the Investment Committee.

2.2 To review progress against the improvement proposals that were agreed by Audit Committee in March 2020.

2.3 To receive a verbal update at the meeting following consideration of the performance review by the Investment Committee at its meeting on the 24th March 2021.

2.4 For Audit Committee members to determine any further recommendations for improvement.

3. KEY ISSUES:

Background

3.1 In May 2018, Council approved a revised Asset Management Strategy, which included an Asset Investment Policy designed to optimise returns from the Councils investment portfolio, including the acquisition or development of new assets or other commercial opportunities.

3.2 The purpose of the policy was to help sustain Council services and enhance the asset base by providing a framework to enable the acquisition of commercial assets to increase net rental income streams and identify capital appreciation opportunities.

3.3 The Council's Corporate Plan identifies five priorities, one of which concerns the Council being 'future focussed'. A key measure of this is income generation from commercial investments. The aforementioned policy provides the criteria for the evaluation of commercial property investment opportunities, which includes security, liquidity and yield criteria.

3.4 The policy sets out the need to seek out investment opportunities within Monmouthshire, the City Deal region and neighbouring areas of economic influence, which support our economic, and regeneration priorities. In order to manage and spread the risk the policy enables us to identify investment options beyond our county boundaries that meet our criteria as well as identifying different property types to minimise risks by both sector and location.

3.5 Acquisitions are funded through approved prudential borrowing with a £50,000,000 fund established to fund acquisitions and investments over a three-year period. The cost of borrowing is funded from the resulting rental streams, with a requirement that it should provide a net surplus over and above borrowing costs.

3.6 An Investment Committee was established to manage the investment portfolio, which has delegated authority to make investments utilising the approved prudential borrowing. The Investment Committee is made up of the Council Leader, Deputy Leader, Cabinet Member for Resources and the Leaders of the two largest opposition parties (political balance 3:1:1). The Committee is advised by the Chief Officer for Resources and officers from Finance, Estates and Legal Services. When considering acquisitions or investments, specialist advisors are used to supplement internal capacity and expertise as appropriate.

3.7 In July 2018, a Commercial Strategy was approved by Cabinet, which reinforces the commercialisation of assets, and in February 2019, Council approved a wider definition of commercial investment. This gave authority to seek investments beyond land and buildings to include:

- Commercial loan facilities
- To build or refurbish investment portfolio holdings
- An equity or debenture interest.

The Asset Investment Policy

3.8 As discussed the Asset Investment Policy sets out the framework and governance criteria for the management of the investment portfolio. The target returns for individual investments is that the returns must exceed borrowing costs by a minimum of 2%, however a lower return can be realised where the investment generates economic development opportunities for Monmouthshire. A target total return of 7% should be achieved.

3.9 As with all investments there are inherent risks, which have been never been more visible that in the current pandemic. All business cases considered by Investment Committee

consider the known risks at the time that the investment is considered, together with proposed mitigating action and potential exit strategies.

3.10 The Investment Committee is responsible for making the decisions on possible investments based on the business cases presented, ensuring that they meet the criteria as set out in the Asset Investment Policy. In addition, the Committee is responsible for ensuring that the assets are effectively managed, performance is monitored and for providing an annual report into Audit Committee.

Audit Committee recommendations 2020

3.11 Members may recall that a number of opportunities for improvement were identified in the first performance review of the investment portfolio, which were agreed by Audit Committee. The following table outlines the progress made against each of these proposals.

To review and update the Asset Investment Policy	An updated Asset Investment Policy was agreed by Council on 3rd December 2020	Completed
To review the Investment Committee Terms of Reference	Updated Terms of Reference were agree by Council on 3rd December 2020. They have been updated to enable deputies to attend with full voting rights, officers and advisors to complete declarations of interests when attending Investment Committee and for the Investment Committee to undertake an annual self-review. In addition all new investment proposals will now need to consider the environmental impact and sustainable development principles as part of the wider business case.	Completed
To ensure that the performance review is undertaken on an annual basis	The first performance review was undertaken in March 2020, this second review is in line with the requirement for an annual review.	On-going as annual requirement
An overarching risk assessment is prepared and reported to Investment Committee on an annual basis.	Risk registers for NLP and Castlegate have been prepared and reported to Investment Committee on a quarterly basis.	On-going
Update the constitution to include details of the Investment Committee.	An amended constitution was agreed by Council in March 2021	Completed
Declarations of interest forms to be completed as required by those attending Investment Committee	This has now been included within the amended terms of reference and agreed by Council.	Completed.
Performance dashboard to be reported to Investment Committee at least twice yearly.	Currently, performance updates have been presented to Investment Committee at no less than a quarterly basis to monitor the impacts of Covid on the investment portfolio.	On-going
To ensure that any investment proposals that are not taken forward are reported back to Investment Committee	This has been actioned and updates are now provided on a quarterly basis.	On-going

To implement the Estates re-structure and to fill current vacancies	The re-structure has progressed and vacancies advertised, however, despite a number of advertising campaigns vacancies remain in the Asset Team and Development Team.	On-going
To assess training needs of staff and members involved in the decision making for commercial investments.	The amended terms of reference require than an annual review of Investment Committee members training needs is undertaken. This will be completed prior to September 2021. Staff involved in the investment proposals are professionally qualified and bound by their professional bodies' codes of conducts not to provide advice in areas where they are not suitably qualified. In addition, professionally qualified staff are required to undertake mandatory continuing professional development on an annual basis. Where training needs are identified for either Members or staff, training will be procured.	On-going
To consider the merits of independent members being added to the Investment Committee	Investment Committee considered this, but determined not to proceed with this proposal on the basis of confidentiality, the broad and changing skill set requirements and potential conflicts of interest that may arise. This decision however will be reviewed on a periodic basis to reflect changing circumstances of the portfolio and the wider economic market.	On-going
To consider the need to re-introduce a sinking fund in earmarked reserves to act as a buffer against any in year deficits caused by investment performance.	This was considered and agreed by Investment Committee on the 14th September 2020.	Completed
To maintain a close ongoing review of further advice and guidance.	An update on the current consultation which proposes changes to Prudential Borrowing and Treasury Management is outlined in this report together with the changes to the PWLB lending criteria	On-going
To procure a new investment advisor for commercial property investments and to ensure all future appointments are made in line with Contract Procedure Rules	Given the current pandemic and the subsequent changes to the Investment Committees appetite for investments, no investment advisors are currently appointed. This situation will be reviewed as and when Investment Committee reviews its position.	Closed
To ensure adequate consideration is given to the climate emergency and environmental considerations of any investments	The Asset Investment Policy has been amended to specifically require the inclusion of an evaluation of the potential environmental impact within the supporting business case for potential investments. The Contract Procedure Rules in the Constitution have been amended and now place environmental considerations alongside economic, social and cultural factors.	Closed

Investment Performance 2020/21

3.12 The current pandemic has highlighted the risks that naturally arise when undertaking commercial investments. The investment and property markets remain uncertain as we

move from the third lockdown with as yet no defined path for the re-opening of the wider leisure or hospitality sectors. In addition, it is unclear how long the requirement for social distancing and other covid security measures will be inforce that limit occupancy levels and subsequent financial viability for wider commercial investments. Investment Committee has therefore concluded that it would not be prudent to undertake any further investments, save for opportunities within the County that are grant funded or support wider policy aims. No new investment activity has been undertaken in the current financial year.

3.13 Investment Committee has continued to regularly monitor the performance of Castlegate Business Park and Newport Leisure Park to ascertain the impact of the pandemic on the rent roll, return on investment, rental arrears and tenant turnover. A summary of the performance over the last 12 months is outlined below.

	Castlegate	Newport Leisure Park
ROI at the time of acquisition	3.76%	2.11%
ROI March 2021	3.57%	1.02%
Occupancy at the time of acquisition	95%	100%
Occupancy March 2021	93.2%	97%
Net income target (2020/2021)	£209,000	£400,000

Castlegate

3.14 Castlegate was acquired in June 2018 for £7m together with a service charge loan of £900k and associated acquisition costs. It is made up of mixed offices and production space amounting to circa 217,000 ft^2 situated in 18 acres of land adjoining the Caldicot settlement. The tenancy schedule has remained largely static over the last twelve months however two of the smaller units have been or about to be vacated. Provisional heads of terms have been agreed with a new occupier, which if it proceeds to completion will improve the occupancy levels and rent-roll.

3.15 There are however a number of tenant break clause events in the next twelve months, which if exercised could have a detrimental impact on the rent roll and occupancy levels. Both have been highlighted to Investment Committee and were considered in the acquisition business case. The capital value of this asset was reduced in March 2020 to reflect the uncertainty of the pandemic and at the time lower occupancy levels.

3.16 The ROI is currently 3.57% and therefore above the required 2% rate. The income target of £209,000 is forecast to be met, however quarter four rent is still being collected. No claims for covid hardship have been made for this site as the tenants have continued to occupy and meet their rental liabilities, albeit monthly payments have been agreed to ease cash flow pressures. In conclusion, given the current circumstances, Castlegate continues to perform well in both financial and economic development terms

Newport Leisure Park

3.17 Newport Leisure Park (NLP) was acquired in March 2019 at a cost of £21m plus land transaction tax and acquisition fees. It is situated on the Newport / Monmouthshire border

and comprises of a mix of six restaurants, two retail units and three leisure units within an 11-acre site. At the time of acquisition, all of the units were let on the basis of long leaseholds with no rental or service charge arrears.

3.18 This investment has been disproportionately impacted by the pandemic due to the leisure and hospitality uses that occupy the site. This has resulted in tenants being unable to trade for substantial periods and for those able to open a reduction in trade due to social distancing and enhanced cleaning requirements to maintain covid security. In addition, two of the tenants, Frankie and Benny's and Pizza Hut entered into CVA's, which saw the closure of the former, and Wright Leisure went into administration. The former Wright Leisure unit has been assigned and the former Frankie and Benny's unit is now under offer.

3.19 Due to the CVA's and current tenant concessions, the rent roll has decreased which has resulted in a reduction in the ROI to 1.02%, below the prescribed 2% requirement. Covid hardship funding has been sought and agreed by Welsh Government for rental shortfalls, which has enabled the asset to meet its £400,000 target. This however provides short-term relief from income losses; however, the long-term impact on the rent roll is yet to be determined as tenants continue to struggle with the impact of the pandemic and the structural changes to the retail and leisure markets.

3.20 In common with all leisure parks, NLP has been badly hit by the impacts of Covid which are reflected in a falling rent-roll, ROI and capital value. It is reasonable to assume that the position will deteriorate further in the short term as consumers are not yet able to access the hospitality and leisure sectors and post opening social distancing will limit capacity levels and financial viability. It is recognised that the ROI has fallen below that prescribed in the asset investment policy, and an options review was undertaken in September 2020, and Investment Committee agreed to retain the asset as the structural impact of covid on the leisure sector will continue to affect realisable capital values. Any sale at this point would result in a reduction in the sale value and the associated disposal fees that will also arise.

3.21 Despite the significant impacts of Covid, the asset does continue to generate a surplus income due to the recovery of lost rental from the covid hardship fund. The level of interest in Unit 5, provides some re-assurance that the site continues to be an attractive proposition to the leisure sector, however it is evident that the demand is changing to the take away / drive through sector as the majority of interest has been for this model.

The Wider National Context

3.22 As reported in the first performance review, the level of commercial investment and subsequent borrowing being incurred by local authorities resulted in the production of property investment guidance from CIPFA. This reinforced the need to have regard to the Prudential and Treasury Management Codes and decisions needing to be prudent, affordable and sustainable. Furthermore, the guidance highlights the need for the risks of investments to be understood and suitably mitigated or managed. The Council has had regard to this guidance and the principles therein in implementing the necessary policy framework and governance arrangements with its commercial investment activity.

3.23 The Welsh Government published revised Investment Guidance in November 2019, which placed additional reporting requirements upon local authorities. The guidance also covers investments that are not part of the treasury management arrangements, e.g. commercial investments including property and loans. The Treasury Policy and Strategy approved by Council in March 2021 have regard to these requirements and has been replicated in Appendix 2.

3.24 In November 2020, the Treasury announced that before being able to access borrowing from the PWLB, local authorities would need to demonstrate that their capital plans do not include any borrowing to buy assets purely to produce a yield, which would no longer be permitted. This was in response to the accelerating levels of borrowing by local authorities to acquire investment property, estimated to be £6.6bn between 2016 and 2019. To access PWLB funding, councils will be asked to submit a high-level summary of capital spending and financing plans for the next three years.

3.25 The Treasury have advised that the PWLB will not lend to a local authority that plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB. Given that the Investment Committee has resolved not to pursue any further investment activity at this time unless it is acquired through grant funding or meets a wider policy ambition within the County, the changes to the PWLB will not have an immediate impact. This however will need to be reviewed if the Investment Committee reviews its investment plans in the longer term.

3.26 In February 2021, CIPFA launched separate consultations on significant amendments to two of its main codes – the Prudential Code and the Treasury Management Code. The areas proposed to be strengthened as part of the amendments are as follows:

Prudential Code

- Provisions within paragraph 45 of the Prudential Code to state clearly that borrowing for debt-for-yield investment is not permissible under the Prudential Code. While recognising that commercial activity is part of regeneration, it does not constitute the primary purpose of investment and unnecessary risk to public funds.

- Any commercial investment undertaken should be consistent with statutory provisions, proportionate to service and revenue budgets and consistent with effective treasury management practice.

- Requirements to assess the affordability of commercial activity within local authorities' capital strategies. CIPFA will also publish, early this year, further guidance on good practice for development of capital strategies.

- The addition of sustainability and ensuring that the capital expenditure is consistent with a local authority's corporate objectives (such as diversity and innovation) to the objectives in the Prudential Code.

- Introduction of new prudential indicators on affordability. External debt to net service expenditure (NSE) ratio, and commercial income to net service expenditure.

- The introduction of the liability benchmark to promote good practice and understanding of local authority's debt management in relation to capital investment.

Treasury management Code

- The Treasury Management Code was last updated in 2017. Since then the landscape for public services has changed. The increasing profile of the role of treasury management as a result of the pandemic, the disciplines and skills required to meet the advances brought forward by issues such as the Markets in Financial Instruments Directive, known as MIFID II, and the increasing complexity of transactions in the sector all underline the importance of the Treasury Management Code and its guidance. In addition, the rise in commercial non-treasury investments is a contributing factor behind the need to strengthen its provisions to ensure that they are fit for the 21st century.

3.27 The Authority will monitor the developments of the code consultation and any resulting requirements from the final code updates for the Authority to incorporate strengthened processes, best practice or new indicators.

3.28 It is important to note however that as part of the Authorities existing Treasury and Capital Strategies for 2021/22, the Authority has already adopted or partially adopted requirements 1, 2, 4, 5 and 6 above in line with best practice and under advice from our Treasury advisors, or as part of the additional requirements of Welsh Government Investment Guidance.

Local Government and Elections Act 2021

3.29 The Local Government and Elections Act will see the introduction of the General Power of Competence in Wales. Consultation has commenced this month and implementation is expected in November 2021. The introduction of the power may provide us with wider opportunities in the future and we will continue to engage with the consultation process and provide further details to Investment Committee as the detail becomes more apparent.

Risk Management

3.29 Whilst each investment will have its own unique characteristics and associated risks, as is the case with any investment, the key risks associated with commercial and property investment activity are:

- That all decisions to incur expenditure are backed be effective legal powers and a resultant risk arises if decisions are subsequently invalidated by changes in statutory provisions or developments in case law, albeit that the retrospective application is unlikely.

- The authorities returns are at risk, while, once incurred borrowing costs are unavoidable. A reduction in returns could put pressure on the authority’s revenue account.

- Capital gains are at risk and in relation to fair value of the property on the balance sheet, for example, where the commercial property fair value is less than the value of the debt liability.

- A risk of proportionality in terms of the extent that the authority's revenue budget is reliant on income from commercial investments.

- A lack of expertise with council staff and those undertaking review and making decisions leading to poor acquisition decisions.

- A downturn in the property market or the market within which the investment is made.

- The long-term structural impact of covid on property sectors and consumers/ workforce behaviours and their resulting capital and revenue values.

3.30 Separate Legal counsel advice has been received and that confirmed that the Council can operate within existing legal powers and guidance and in making the commercial investments as intended. Legal advice is sought separately for each commercial investment being considered.

3.31 Business cases that are developed and considered by Investment Committee undertake a full and proper assessment of risk and associated risk management and mitigation strategies. Business cases are supported by detailed commercial, financial and legal due diligence, with external advisors appointed as required to supplement the experienced staff within Legal, Finance and Estates.

3.32 Proposals presented to Investment Committee seek to describe the opportunity being considered from the perspective of the cash flows 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.

3.33 Ongoing monitoring of the investments takes place and risks are continually assessed. Business cases have exit strategies to mitigate any situation where a long term erosion of capital value is anticipated. The impact of the covid pandemic has highlighted the importance of this on-going review and that not all risks can be predicted at the point of business case formulation.

3.34 Prudential indicators monitor and contain local authority borrowing levels and commercial investment activity is separately shown and further supported by the additional reporting requirements necessitated by Welsh Government Investment guidance.

4. OPTIONS APPRAISAL

4.1 This report is not a decision making report. It represents a performance review of the Investment Committee and therefore no option appraisal is required.

5. EVALUATION CRITERIA

5.1 Evaluation is undertaken and required at a number of stages being:

a) When an investment opportunity is identified or an investment proposal received and Investment Committee agrees for due diligence to be undertaken.

b) On the submission of a proposal or business case to the Investment Committee for consideration

c) On an ongoing basis as part of the routine and regular monitoring of commercial investments – reporting and taking action as required.

d) As part of the annual performance review that is a requirement of the Asset Investment policy – acting on proposals for improvement, and

e) As part of the internal and external reviews undertaken – acting on recommendations and proposals for improvement.

5.2 The results of the evaluation arising from this performance review are outlined in 3.33 together with the resource implications shown below.

6. REASONS

6.1 The Asset Investment Policy requires an annual performance review of the Investment Committee to be undertaken and in order to ensure that the governance arrangements, policy documentation and necessary guidance and legislation are being reviewed and adhered to.

7. RESOURCE IMPLICATIONS:

7.1 As stated above the two investment acquisitions to date relate to Castlegate Business Park and Newport Leisure Park.

7.2 £30.7m has been spent to date on the two acquisitions. Any additional costs of due diligence and advice incurred in exploring other commercial investment opportunities have been met from existing revenue budgets.

7.3 As a result of the acquisitions made budgeted savings have been introduced and form part of the revenue budget savings. The budgeted level of savings for Castlegate Business Park and Newport Leisure Park are £209k and £400k respectively. Most recent forecasts for the current financial year indicate that both targets will be met. The latter due to revenue loss payments from the covid hardship fund.

7.4 As outlined in 3.13, the investment return over borrowing (ROI) for Castlegate is 3.57% with an occupancy rate of 93%.Whist the occupancy rate has declined slightly since the original acquisition, the site has continued to trade well during the last twelve months and provisional terms have been agreed for a new letting.

7.5 Newport Leisure Park at the time of acquisition was 100% occupancy and an ROI of 2.11%. Due to the impact of the pandemic, the occupancy rate has fallen to 97% and the ROI to 1.02%. The ROI has reduced due to the impact of CVA agreements on the rent roll together with tenant inducements. Discussions are underway with tenants to establish their plans to meet lease obligations and their emergence from the current lockdown. Heads of terms have been agreed for a potential letting of the vacated unit.

7.6 The capital values of both assets have decreased in the last year reflecting the impact of the pandemic on rent rolls and occupation levels. This is reviewed on an annual basis, however it is anticipated that NLP will continue to see a reduction in its capital value until the impact of the CVA's can be mitigated.

7.7 In terms of arrears of rent and service charge, there are no significant issues at Castlegate. Two occupiers of Newport Leisure Park have arrears of one quarters rent that accrued prior to the March 2020 lockdown. Discussions are ongoing with the tenants to establish payment plans to recover these arrears.

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

There are no equality, Future Generations or wider implications directly arising from this report. This report is seeking to provide a review of performance. Any implications will be assessed as required by the Investment Committee when considering any investment.

9. CONSULTEES

Chief Officer for Resources (S151 Officer)
Head of Legal Services (Monitoring Officer)
Head of Commercial, Property, Fleet and Facilities

10. BACKGROUND PAPERS:

Appendix 1 – Asset Investment Policy December 2020
Appendix 2 – Treasury Policy & Strategy 2021-22
Appendix 3 – Investment Committee Terms of Reference

11. AUTHOR:

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