

FINANCE, AUDIT & RISK COMMITTEE

21 MARCH 2018

*PART 1 – PUBLIC DOCUMENT

AGENDA ITEM No.

16

TITLE OF REPORT: STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

REPORT OF THE HEAD OF FINANCE, PERFORMANCE AND ASSET MANAGEMENT

EXECUTIVE MEMBER: *N/a*

COUNCIL PRIORITY: RESPONSIVE AND EFFICIENT

1. EXECUTIVE SUMMARY

1.1 To provide the Committee with details of the statutory guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) on Local Government Investments.

2. RECOMMENDATIONS

2.1 That the Committee note and comment on the contents of the report.

3. REASONS FOR RECOMMENDATIONS

3.1 This is statutory guidance and therefore there is a requirement for the Council to comply with it.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 None considered as this relates to statutory guidance.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

5.1 The purpose of this report is to make the Committee aware of the new guidance and therefore there is no requirement for consultation.

6. FORWARD PLAN

6.1 This report does not contain a recommendation on a key decision and has not been referred to in the Forward Plan.

7. BACKGROUND

7.1 With reductions in Central Government funding, Local Authorities have been under pressure to make efficiency savings, reduce service levels or generate income. The Localism Act (2011) gave Local Authorities much greater powers in terms of what they

can do and these have been used to find new ways of generating income. This has received particular attention in relation to borrowing money for the purposes of investing in capital assets that will provide a greater level of return than the associated borrowing costs. This has been seen by some as Local Authorities taking on too much risk and also distorting the opportunities for private sector property investment.

- 7.2 On the 2nd February 2018, the Ministry for Housing, Communities and Local Government issued new guidance in respect of capital finance and Local Government capital investments.

8. RELEVANT CONSIDERATIONS

- 8.1 The following paragraphs detail the key new requirements that this statutory guidance introduces and they impact on the Council.

- 8.2 Previous legislation required that an Authority should have a Treasury Strategy that was approved each year by Full Council. Any deviation from that strategy would require a report back to Full Council. The new guidance effectively terms this an Investment Strategy and extends the definition of what this should cover to also include:

- non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios.
- Loans made to a wholly-owned trading company, a joint venture or a third party.

The Council has a portfolio of historic investment properties which are generally ground leases on industrial units. It also currently has a loan to Herts Building Control which was to help set it up.

- 8.3 The requirements in relation to treasury investments are unchanged and require an assessment of Security, Liquidity and Yield, in that order of importance. For all other investments there is a requirement to show:

- How they contribute towards the objectives of the Council and/or how they contribute towards the place making role of the Council.
- Through quantitative indicators, an assessment of the Council's risk exposure. This should include the rate of return (yield) and where they are funded from borrowing the cost of that debt.

The investment properties that the Council own are primarily held for the income that they provide, although they do partially support local businesses. As they are ground leases the risk of them is very low. The loan to Herts Building Control is to help develop a cost effective way of delivering this service. As it is a loan to a new company it is relatively high risk, although the latest business plan seems positive and the risk is shared between 7 authorities. The Council only has a small amount of historic borrowing that is not cost effective to pay back, and therefore none of these investments are funded from borrowing. We will develop some ideas of appropriate quantitative indicators and report back to the Committee in the Autumn.

- 8.4 It is up to the Council to determine its own risk profile in relation to non-treasury investments. There is a requirement to assess security, liquidity and yield, but they do not have to be in that order of importance. There should be a requirement to achieve a certain level of security and liquidity (which the Council can determine), but after that yield could be prioritised.

- 8.5 The Council is still able to loan money to other organisations where the aim is to promote economic growth, and these loans would not generally be seen as prudent

when purely assessing security and liquidity. The requirements are that the amounts (individually and in total) are proportionate and that any overdue repayments are chased. The Council does not currently have any of these investments and does not plan to do so.

8.6 For non-financial investments there is a requirement to carry out an annual valuation to ensure that the underlying asset still has sufficient value to provide security. If this is not the case there is a requirement to detail what is going to be done about it. The Council's investment properties are already valued on an annual basis. As they are generally ground leases there is a long-term obligation to pay an annual amount to the Council. If these amounts were not paid then the Council would get back the land as well as any buildings that the lessee had built on it.

8.7 The investment strategy should detail the Council's approach to assessing risk. This will include things like:

- Assessment of the market and competition.
- Use of external advisors and how the quality of these will be assessed.
- Use of credit ratings and how often these will be updated.

The actual use of these will depend partly on the type of investment, and given the Council's current non-financial investments, will be more appropriate for any new investments. The Committee will be aware of potential investments in relation to the Churchgate Shopping Centre and Royston Leisure Centre. Any business case for these will include an appropriate assessment of risk.

8.8 There is also a requirement to determine the Council's approach to the liquidity of non-financial investments. The guidance appreciates that capital assets can be fairly illiquid, as they would take a long time to sell. For any new non-financial investments that the Council undertakes, the business case will fully assess exit routes. Given the potential proposal in relation to Churchgate, it will probably be necessary for the Council to consider illiquid investments where they primarily provide wider regenerative benefits.

8.9 Where the Council is (or plans to become) reliant on profit generating investment activity to balance its budgets, there is a requirement to disclose the extent that the level of profit is required and any contingency periods. It is recommended that this assessment is over a longer period than the usual 5 years. Whilst the Council continues to expend its focus on ways of generating income from capital investment, it does not yet plan to become reliant on this to achieve a balanced budget.

8.10 The Prudential Code states that an authority should not borrow in advance of need. This has generally meant that an authority can only borrow for capital investment when it has run out of capital reserves i.e. it can not borrow at a low rate to try and achieve treasury returns at a higher rate. This guidance extends this to include non-financial investments. For example, on the face of it this would appear to prevent borrowing for the redevelopment of the Churchgate Shopping Centre. However it is considered that this extension is actually intended to cover investments that do not in any way contribute towards the general objectives of the Council e.g. investing outside of the Authorities boundary. Furthermore the guidance does allow Authorities to ignore this requirement as long as they explain why and comment on how they will manage the risk.

8.11 The Investment Strategy is required to disclose the steps taken to ensure that those elected members and statutory officers involved in investment decision making process have appropriate capacity, skills and information to enable them to take informed decisions. These informed decisions should include an appropriate understanding and

assessment of risk. To help meet this requirement, the Head of Finance, Performance and Asset Management is arranging a training session on risk that will be available to all Councillors. All Council reports include a 'risk implications' section and this should be seen as key for reports which relate to investment decisions. The Finance, Audit and Risk Committee may want to consider the role that they take in this.

9. LEGAL IMPLICATIONS

- 9.1 The Guidance was issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. Under that section local authorities are required to "have regard" to "such guidance as the Secretary of State may issue.
- 9.2 10.1.5 (c) of the Committee's terms of reference includes: "*To consider the Council's policy in relation to Treasury Management and make recommendations on the Annual Treasury Management and Investment Strategy, and Treasury Management Code of Practice.*" Statutory guidance on investment considerations are therefore relevant to this function.

10. FINANCIAL IMPLICATIONS

- 10.1 The Council regards a prime objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, the Treasury Management Strategy ensures that its counterparty lists and limits reflects a prudent attitude towards organisations with whom funds are deposited, and limits its investment activities to the instruments, methods and techniques referred to in the Treasury Management Practices adopted by the Authority. The Council will ensure it has adequate, though not excessive, cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.
- 10.2 The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within this clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the Authority.

11. RISK IMPLICATIONS

- 11.1 Risks in relation to investments are covered in section 8.

12. EQUALITIES IMPLICATIONS

- 12.1 In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.
- 12.2 There are no equalities implications arising from this report. Where relevant, specific capital investments would be subject to an equalities impact assessment.

13. SOCIAL VALUE IMPLICATIONS

13.1 The Social Value Act and “go local” policy do not apply to this report.

14. HUMAN RESOURCE IMPLICATIONS

14.1 It is expected that this guidance will create more work for the Accountancy team when preparing the budget reports for 2019/20 onwards. It is currently expected that this additional work can be absorbed within existing workloads.

15. APPENDICES

15.1 None.

16. CONTACT OFFICERS

16.1 Ian Couper, Head of Finance, Performance and Asset Management
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17. BACKGROUND PAPERS

MHCLG Statutory Guidance on Local Government Investments
[https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/
Guidance_on_local_government_investments.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf)