APPENDIX B

HENLEY ON THAMES TOWN COUNCIL
INVESTMENT STRATEGY 2018-19 – revised 19 June 2018

1. Introduction

- This Strategy complies with the revised requirements set out in
  - the Department for Communities and Local Government *Statutory Guidance on Local Government Investments (3rd Edition)* (Appendix A)
  - Guidance within Governance and Accountability for Local Councils *Practitioners Guide.*
  - Chartered Institute of Public Finance and Accountancy's *Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes*
- The definition of an investment covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit. For Henley on Thames Town Council the financial assets include cash balances and funds held with investment managers (stocks and shares). It also includes non-financial assets defined in the Council's accounts as 'investment properties'. The definition also covers loans, whether written or oral, where a local authority temporarily transfers cash to a third party.
- Henley on Thames Town Council (the Council) acknowledges the importance of prudently managing the funds it holds on behalf of the community.
- The requirements set out above provide a basis to create clear treasury management objectives and to structure sound treasury management policies and practices.
- The requirements also provide a basis for managing the Council's property investments and loans to third parties.
- This Council defines its treasury management activities as:
  "The management of the Council's cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."
- This Council will not borrow in order to profit from investment of the sums borrowed.

2. Types of Investment

- Investments made by Local Authorities can be classified as:
  a) Investments held for treasury management purposes (for Henley Town Council bank balances and share portfolios);
  b) Other investments (and investment properties). Other investments can be financial (loans to third parties) or non-financial (eg properties generally held with a view to generating a profit).
- For Investments held for treasury management purposes the Council sets out its strategy at 4 below.

- For loans to third parties the Council sets out its strategy at 5 below.
- For non-financial investments (investment properties) the Council sets out its strategy at 6 below.

3. Objectives

- The Council acknowledges that the pursuit of best value management and the use of suitable performance measures are valid and important tools to employ in support of their business and service objectives;
- Subject to the over-riding security objective above, the Council's objectives for long term investments identified at 4 below is that the 'net of costs' target return in the longer term preserves the real value of the fund measured against RPI plus the requirement for investment income of around 3.5%. On the basis that the ten year RPI increase to Sept 2017 was 30.0%, an average of 3% per year, this gives a current target total return of 6.5% per year net of all charges. For 2018-19 the budget for the income return is £165k (3.6% of the market value of £4.6m)
- Loans to third parties form part of this investment strategy and the objective for this type of investment is full repayment of the loan and payment of interest in accordance with the loan agreement. For any new loans interest should be charged at a rate of 2.5% above the Bank of England base rate in accordance with the Council's loans policy.
- Investment properties (36 Market Place and an equity share in specified properties) also form part of this investment strategy and the objective is to preserve or increase the asset value and in the case of 36 Market Place for the yield to be in line with the open market rental value.

4. Investments Held for Treasury Management Purposes

- The Council recognizes the importance of **security, liquidity and yield, in that order**, in managing its investments held for Treasury Management Purposes.
- From time to time the Council may have a temporary surplus of working capital cash, referred in statute as specified investment. For the prudent management of its treasury balances the Council will use deposits with banks, building societies, local authorities or other public authorities with an A1/A+ rating from a credit rating agency such as Standard and Poor's or Moody's Investors Service. These funds may be invested for periods of less than 12 months.
- The Council currently has substantial funds available in the form of investment portfolios for longer term capital developments and to fund Income and Expenditure deficits. These are termed non-specified investments.
- The Council's investments are currently split between two Investment Managers (IMs) to be managed on a discretionary basis which will allow the fund managers to take decisions without prior referral. Both IMs will strive to achieve the investment objectives indicated at point 3 above.
- In achieving these investment objectives the IMs must work within the following parameters. Percentage limits apply to stocks held directly or indirectly through managed funds:

a) To manage volatility risk, no more than 70% of the portfolio should be invested in equities;
b) To manage exchange rate risk, non-sterling denominated assets should not exceed 40% of the portfolio value;
c) To manage risk and ensure adequate liquidity 95% of investments should be generally realisable within 21 days. Exposure to funds that trade infrequently should be kept to a minimum;
d) To ensure diversification, a maximum of 10% of the portfolio value should be invested in any one holding. This would include indirect holdings in managed funds and Unit Trusts;
e) To manage security risk a maximum of 15% of the portfolio value should be held in non-investment grade instruments.
f) To further manage security risk, the Council does not view derivatives or structured products as suitable asset classes in their own right. An element of derivative use may be appropriate but only when used for broader purposes, for example within a fund that has foreign currency exposure to hedge that risk.

- IMs will be required to present monthly valuations and transaction reports, and quarterly reports to include market reviews and forecasts and total return figures. Total return figures should be time weighted and shown against the following indices: RPI, WMA Income Index and the FTSE All Share Index. Summary figures and reports will be required annually in October/November at a presentation to the FSM Committee. IMs will be required to attend the annual presentation.
- IMs must be directly authorised and regulated in the UK by the FCA or any successor body.
- Where IMs provide for custody of assets under nominee companies they must utilize custody arrangements that comply fully with the UK FCA's Client Assets (CASS) sourcebook at all times.
- IMs must demonstrate that they carry valid Liability Insurance cover for their nominee companies of over £10m per claim.
- The choice of IMs was reviewed in 2016-17. A further review should take place by 31st March 2022.
- The Responsible Finance Officer will provide at least one month's notice to the IMs of any impending major capital withdrawals.

5. Other Financial Investments - Loans to Third Parties

- The Statutory Guidance on Local Government Investments (3rd Edition) allows local authorities to make loans to third parties including charities and local enterprises even though those loans may not all be seen as prudent if adopting a narrow definition of prioritizing security and liquidity.
- The Council sets the following provisions regarding its loans to third parties:
  a) Total exposure should be limited and proportionate, being limited to the lower of £500k or 10% of total usable reserves (ie excluding revaluation reserves).
  b) In recognition of possible losses in the value of loans it is suggested that the recoverable value of all loan balances are assessed at the end

of each financial year, taking into account relevant, reasonable and supportable information about future expectations.

c) Credit control arrangements should be in place to recover overdue repayments

6. Other Investments – Non-Financial

- The Council should obtain a fair market value for investment properties at each year end provided by an independent valuer with the appropriate RICS qualifications.
- The Council should seek to maintain the value by ensuring that tenants are legally required to look after the property by way of an appropriate full repair lease or other legal documentation, and that regular (five-yearly) property surveys are undertaken.

6. Review and Amendment of Regulations

- For the purposes of transparency and accountability this Strategy will be reviewed annually. The Strategy for each coming financial year will be prepared by the Accountant and presented for approval to the Finance, Strategy and Management Committee before the start of the financial year, normally the previous October.
- Any material change during the year should be presented to Full Council before the change is implemented.
- In accordance with the Freedom of Information Act 2000, this Document will be posted on the Council's Website: www.henleytowncouncil.gov.uk
- The Council reserves the right to make variations to the Strategy at any time, subject to the approval of the full Council. Any variations will be made available to the public on the website.

7. Alternative Formats

- Disability Discrimination Act 1995 – copies of this document in large print (A3 Format) or larger font size can be made available for those with sight impairment on request from the Council Office or by telephoning 01491 576982 or e-mailing enquiries@henleytowncouncil.gov.uk

Appendix A

Department for Communities and Local Government

STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

(3rd Edition)

POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is 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".

DEFINITION OF TERMS

2. In this guidance the **2003 Act** means the Local Government Act 2003.

3. **Local authority** has the meaning given in section 23 of the 2003 Act. To the extent that this guidance applies to parish councils and charter trustees (see paragraph 11) a reference to a local authority includes those councils and trustees.

4. The definition of an **investment** covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

5. For the avoidance of doubt, the definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party. The term does not include pension funds or trust fund investments, which are subject to separate regulatory regimes and therefore are not covered by this guidance.

6. A credit rating agency is one of the following three companies:

- Standard and Poor's;
- Moody's Investors Service Ltd; and
- Fitch Ratings Ltd.

7. For the purposes of this guidance a **loan** is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who promises to return it according to the terms of the agreement, normally with interest. This definition does not include a loan to another local authority, which is classified as a specified investment.

8. **The Treasury Management Code** means the statutory code of practice issued by CIPFA: "*Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition*".

9. **The Prudential Code** means the statutory code of practice, issued by CIPFA: "*The Prudential Code for Capital Finance in Local Authorities, 2017 Edition*".

10. The Capital Strategy is the strategy required by the updates to the Prudential Code and Treasury Management Code.

APPLICATION

Effective date

11. This guidance applies for financial years commencing on or after 1 April 2018. It supersedes all previous editions of the Statutory Guidance on Local Authority Investments.

12. Strategies presented to Council or equivalent before 1 April 2018 but relating to 2018-19 and future financial years do not need to include all of the additional disclosures required by this edition of the guidance should it not prove practical or cost effective to do so. If a local authority chooses not to include the new disclosures in its 2018-19 Strategy, it must include the disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

Local authorities

13. This guidance applies to all local authorities in England.

14. This guidance applies to parish councils and charter trustees, providing their total investments exceed or are expected to exceed £100,000 at any time during the financial year. Where a parish council or charter trustee expects its total investments to be between £10,000 and £100,000, it is encouraged to adopt the principles in this guidance.

KEY PRINCIPLES

Transparency and democratic accountability

15. For each financial year, a local authority should prepare at least one Investment Strategy ("the Strategy"). The Strategy should contain the disclosures and reporting requirements specified in this guidance.

16. The Strategy should be approved by the full council. For authorities without a full Council, the Strategy should be approved at the closest equivalent level. The Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

17. Where a local authority proposes to make a material change to its Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

18. The Strategy should be publicly available on a local authority's website. Where a parish council or charter trustee does not maintain its own website, they should post a public notice detailing how local residents can obtain a copy of the Strategy, free of charge.

19. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Strategy can be published in those documents instead of in the Strategy.

Contribution

20. Investments made by local authorities can be classified into one of two main categories:

- Investments held for treasury management purposes; and
- Other investments.

21. Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance.

22. Local authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority. It is for each local authority to define the types of contribution that investments can make and a single investment can make more than one type of contribution.

Use of indicators

23. The Strategy should include quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return received. Where investment decisions are funded by borrowing the indicators used should reflect the additional debt servicing costs taken on.

24. Local authorities should consider the most appropriate indicators to use, given their risk appetite and capital and investment strategies. Whilst this guidance does not prescribe specific indicators or thresholds, the indicators used should be consistent from year to year and should be presented in a way that allows elected members and the general public to understand a local authorities' total risk exposure from treasury management and other types of investment.

25. Where a local authority has entered into a long term investment or has taken out long term debt to finance an investment the indicators used should allow Councillors and the general public to assess the risks and opportunities of the investment over both its payback period and over the repayment period of any debt taken out.

Security, Liquidity and Yield

26. A prudent investment policy will have two underlying objectives:

- **Security** – protecting the capital sum invested from loss; and
- **Liquidity** – ensuring the funds invested are available for expenditure when needed.

27. The generation of **yield** is distinct from these prudential objectives. However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these priorities.

28. When entering into treasury management investments, local authorities should consider security, liquidity and yield in that order of importance.

29. When entering into other types of investments local authorities should consider the balance between security, liquidity and yield based on their risk appetite and the contribution(s) of that investment activity.

Security

Financial Investments

30. Financial investments can fall into one of three categories:

- Specified investments;
- Loans; and
- Other Non-specified investments.

Specified Investments

31. An investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling.
- The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a non-conditional option.
- The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].*

- The investment is made with a body or in an investment scheme described as high quality (see paragraph 33 or with one of the following bodies:
  i. The United Kingdom Government;
  ii. A local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; or
  iii. A parish council or community council.

32. For the purposes of paragraph 32 the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 42 is relevant.

<u>Loans</u>

33. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

34. Local authorities can make such loans whilst continuing to have regard to this guidance if they can demonstrate in their Strategy that:

- Total financial exposure to these type of loans is proportionate;
- They have used an allowed "expected credit loss" model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 *Financial Instruments* as adopted by proper practices to measure the credit risk of their loan portfolio;
- They have appropriate credit control arrangements to recover overdue repayments in place; and
- The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

<u>Non-specified investments</u>

35. A non-specified investment is any financial investment that is not a loan and does not meet the criteria to be treated as a specified investment.

36. For non-specified investments (i.e. those not meeting the criteria in paragraph 31), the Strategy should:

- Set out procedures for determining which categories of investments may be prudently used (and where these procedures involve the use of credit ratings, paragraph 32 is relevant).
- Identify which categories of investments have been defined as suitable for use.
- State the upper limits for the maximum amounts both individually and cumulatively that may be held in each identified category and for the overall amount held in non-specified investments and confirm that

investments made have remained within those limits.

Non-financial investments

37. As defined in paragraph 4 of this guidance, non-financial investments are non-financial assets that the organisation holds primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.

38. Where the fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

39. Where the fair value of non-financial investments is no longer sufficient to provide security against loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

40. Where a local authority recognises a loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Risk Assessment

41. The Strategy should state the local authority's approach to assessing risk of loss before entering into and whilst holding an investment, making clear in particular:

- How it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements.
- Whether and, if so how, a local authority uses external advisors be they treasury management advisors, property investment advisors or any other relevant persons.
- How the local authority monitors and maintains the quality of advice provided by external advisors.
- To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies.
- Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.
- What other sources of information are used to assess and monitor risk.

Liquidity

42. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed and state what those maximum periods are and how the local authority will stay within its stated investment limits.

43. For non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at a portfolio level if appropriate.

Proportionality

44. Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and/or place making role of that local authority is dependent on achieving the expected net profit. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net profit.

45. The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

Borrowing in advance of need

46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:

- Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and
- The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

Capacity, skills and culture

48. The Strategy should disclose the steps taken to ensure that those elected members and statutory officers involved in the investments decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment, to assess individual assessments in the context of the strategic objectives and risk profile of the local authority and to enable

them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

49. The Strategy should disclose the steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

50. Where appropriate the Strategy should comment on the corporate governance arrangements that have been put in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

ANNEX A – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Power under which this Guidance is issued [paragraph 1]

1. **The Local Government Act 2003**, section 15(1), requires a local authority "…to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify…".

2. The guidance on investments in the main part of this document is issued under section 15(1) of the 2003 Act and authorities are therefore required to have regard to it. This part (**Annex A**) contains an informal commentary ("the commentary") on the Statutory Guidance.

3. Two codes of practice issued by the *Chartered Institute of Public Finance and Accountancy* (CIPFA) contain investment guidance which complements the MHCLG guidance. These publications are:

- *Treasury Management in the Public Services: Code of Practice and CrossSectoral Guidance Notes*
- *The Prudential Code for Capital Finance in Local Authorities*

4. Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] as amended.*

Objectives in updating the Guidance

5. The 2nd edition of this Guidance, which was issued in 2010, reflected concerns raised by the CLG and Treasury Select committees as part of their enquiries into the financial crash of 2007-8. The key areas of focus were:

- The practice of investing for yield, especially in Icelandic Banks;
- The need for transparent investment strategies; and
- The use of Treasury Management advisors.

6. The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

7. In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

- Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
- There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and

- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

Effective Date [paragraphs 11-12]

8. This Guidance applies from 1 April 2018. It supersedes all previous editions of the Guidance.

9. The Guidance requires local authorities to produce a number of additional disclosures. Many local authorities already produce these as part of internal reporting and risk management procedures. However, if these disclosures are not currently produced, then local authorities do not need to prepare them in full for Strategies presented to full Council or equivalent before 1 April 2018. Those local authorities who do not include the required disclosures in their 2018-19 strategies, should present them for approval the first time the relevant Strategy is updated or superseded.

Local Authorities [paragraphs 12-13]

10. This Guidance applies to all local authorities, who hold or during the next financial year intend to hold financial or non-financial investments, solely or in part to generate revenue income.

11. It applies to parish councils whose investments exceed the thresholds set out in paragraph 14. The decision to lower the financial threshold for parish councils has been taken in recognition that some parishes have begun to engage in commercial ventures. As parish councils tend to be fairly small and to obtain a greater percentage of their funding directly from council tax payers than other types of local authority, it is right that they demonstrate that they have carefully considered the expertise that they need to manage the risks arising from their strategy.

Transparency and democratic accountability [paragraphs 15-19]

12. The Government believes that local authorities need to be better at explaining "why" not just "what" they are doing with their investment activity. That means that the sector needs to demonstrate more transparency and openness and to make it easier for informed observers to understand how good governance and democratic accountability have been exercised.

13. The additional disclosures required by the Guidance should be included in a single document presented to full Council or the equivalent. Although the Guidance refers to an Investment Strategy, providing that all of the disclosures are easy for interested parties to find and are in or linked from a single document, a separate Strategy does not need to be prepared. The Strategy should be updated at least annually.

14. Subject to the provisions in paragraph 35 and 36 of the commentary, local authorities can exclude specific non-financial investments from the required disclosures on grounds of commercial confidentiality. The Government expects that non-disclosure on grounds of commercial confidentiality will be an exceptional circumstance. A local

authority should only determine that it would breach commercial confidentiality to include an investment in the disclosures on receipt of appropriate professional advice, using the same criteria as would be used to exclude the public from a Council meeting. Local authorities should reassess whether the commercial confidentiality test is met every time a new Strategy is presented to full Council or the equivalent.

15. Under Regulation 17 of *The Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012* as amended overview and scrutiny committee members have right of access to any confidential information relating to any decision by any committee or any member of the executive of their council. Nothing in this Guidance has the power to override this regulation.

16. Assets that generate revenue income solely through fees and charges for discretionary services levied under Section 93 of the Local Government Act 2003 should not be classified as non-financial investments for this purpose.

17. If disclosures are already produced in another document that is publicly available then a local authority can provide a link to the disclosures from the Strategy rather than reproducing them. The exception is disclosures contained in the Statutory Accounts, which do not meet the requirements of this Strategy. This is because local authority statutory accounts can be complex and difficult for users who are not familiar with local government accounting to understand and statutory accounts are prepared to a higher level of materiality than local authorities should use for internal risk management.

<u>Contribution [paragraphs 20-22]</u>

18. Local authorities may have several different objectives, when deciding to acquire an asset. If an asset is not solely held for yield, then a local authority may have a different risk appetite or be willing to accept a lower return than it otherwise would.

19. Each local authority should determine how it categorises different types of contribution, and each investment can have more than one type of contribution. A non-exhaustive list of types of contribution include:

- Yield/profit
- Regeneration
- Economic benefit/business rates growth
- Responding to local market failure
- Treasury management

20. Where a local authority classifies an investment as contributing to regeneration or local economic benefit, it should be able to demonstrate that the investment forms part of a project in its Local Plan.

<u>Use of indicators [paragraphs 23-25]</u>

21. Local authorities should present a range of indicators to allow members and other interested parties to understand the total exposure from borrowing and investment decisions. The indicators should cover both the local authority's current position and the

expected position assuming all planned investments for the following year are completed. The indicators do not need to take account of Treasury Management investments unless these are expected to be held for more than 12 months.

22. The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. We recommend that, the indicators in the table below are used. Where local authorities have a different risk appetite or different expectation of returns depending on the contribution(s) each type of investment makes, they should consider presenting the indicators, classified by type of contribution or risk appetite.

Debt to net service expenditure (NSE) ratio: *Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.* Commercial income to NSE ratio: *Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.* Investment cover ratio: *The total net income from property investments, compared to the interest expense.* Loan to value ratio: *The amount of debt compared to the total asset value.* Target income returns: *Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties*. Benchmarking of returns: *As a measure against other investments and against other council's property portfolios.* Gross and net income: *The income received from the investment portfolio at a gross level and net level (less costs) over time.* Operating costs: *The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.* Vacancy levels and Tenant exposures for nonfinancial investments: *Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.*

23. Where appropriate, local authorities should consider including targets or limits set by members alongside the outturn. Where there has been a significant change in year

on year performance against any of the indicators presented local authorities should include an explanation in the Strategy.

24. Local authorities can choose to present additional indicators in the Strategy should they believe that it would enhance understandability and transparency to do so.

Security, liquidity and yield [paragraphs 26-29]

25. For treasury management and other financial investments local authorities should continue to prioritise **SECURITY, LIQUIDITY** and **YIELD** in that order of importance.

26. Whilst consideration of security and liquidity is important for loans and nonfinancial investments, the relative balance between objectives may be different depending on the nature and objectives in making a specific investment.

Security and liquidity

Loans [paragraphs 33 – 34, 40]

27. Loans to joint ventures, local SMEs or third sector bodies, and wholly owned companies fall within the scope of the Guidance. When considering security and liquidity of loans local authorities should set limits for their total exposure and apply the expected loss model in line with the requirements of IFRS 9 Financial Instruments.

Non-financial investments [paragraphs 37-40, 43]

28. Where a local authority has a non-financial investment, it will have an asset that can be realised to recoup the sums invested. Therefore, the Guidance requires local authorities to consider security by reference to the value of the asset relative to purchase price and to set out the plans to recoup the investment if realising the asset would not recoup the sums invested. In the period immediately after purchase, it is normal for the directly attributable costs of purchasing an nonfinancial investment to be greater than the realisable value of the asset. In this scenario, all the Strategy needs to disclose is how long the local authority expects it to take for the increase in asset values to provide security for the sums invested and the assumptions underpinning that expectation.

29. Non-financial investments are by their nature illiquid. However, this does not mean that the local authority does not need to plan for realising a part of its nonfinancial investment portfolio, for example to repay debt. The liquidity of the nonfinancial investment portfolio should be considered over the repayment period of any debt taken out to acquire assets, which could be very long term. Given current trends such as the scale and pace of technology driven change, there is no guarantee that non-financial investments will continue to deliver value over their lifetime. To manage this risk, local authorities need to have plans to realise the capital tied up in non-financial investments if required. In addition, the Strategy should consider the trade-offs between accepting capital loss and refinancing debt incurring additional debt servicing costs by doing so, if appropriate.

Proportionality [paragraphs 44-45]

30. Local authorities need to consider the long term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure.

31. In addition, whilst under statute, local authority debt is secured on the revenues of that authority, in practice, there is no realistic prospect of the revenues of any local authority being sufficient to pay back debt equating to many multiples of the sum of NNDR and Council Tax Income, without a pervasive and long term impact on service delivery. It is unclear whether local authorities who have adopted a debt financed commercial investment strategy have realistic plans to manage failure. Whilst the Government recognises the importance of local authorities taking on debt to enhance service provision, irrespective of the source of finance, it does not believe that it should do the same for commercial investments.

32. For this reason, the Guidance introduces a new requirement that in every local authority, full council or its nearest equivalent, sets limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure.

33. If a local authority has exceeded these limits through investments taken out prior to the introduction of this Guidance, it does not need to dispose of investments currently held. However, authorities who have exceeded their self-assessed limits should not enter into any further investments, irrespective of how these are financed, other than short term investments required for efficient treasury management.

Borrowing in advance of need [paragraphs 46-47]

34. The Prudential Code, issued by CIPFA has always contained a statement that local authorities should not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The purpose of repeating that statement in this Guidance is to make it clear that it extends to borrowing taken on to finance the acquisition of non-financial as well as financial investments.

35. Local authorities can still finance the acquisition of financial on non financial investments from capital receipts generated from the sale of surplus assets. However, they should not repurpose receipts allocated to the acquisition of assets that contribute to service delivery to fund the purchase of investments, solely to avoid the requirements against borrowing in advance of need.

36. If exceptionally a local authority, chooses not to have regard to the provision on borrowing to fund investment activity the Guidance requires them to explain, in their Strategy, the rationale for this decision.

37. The purpose of this disclosure is to allow external auditors, tax payers and other interested parties to understand why the local authority has chosen to disregard the

Guidance, and to hold the authority to account should they believe there is not sufficient reason for doing so.

Capacity, Skills and Culture [paragraphs 48-50]

38. In the Public Accounts Committee report of 18 November 2016 members raised concerns that locally elected members may not always have the background and expertise to understand the risks associated with the decisions that they are being asked to make. For this reason the Guidance extends the requirements on capacity and skills to members and any statutory officers involved in or responsible for signing off on investment decisions.

39. Members do not necessarily need formal training in understanding investment risks to satisfy the requirements of the Guidance. Depending on their level of expertise a presentation setting out the risks and opportunities of an investment strategy/specific investment in terms a layman would understand, may be sufficient to meet the new requirements.

40. The Government is aware that many local authorities have brought in outside expertise to identify and negotiate investment opportunities. Whilst this can be an effective method of risk management, it is important that those negotiating deals understand that they are not operating in a purely commercial environment and that the prime purpose of a local authority is to deliver statutory services to local residents. Therefore, the Strategy should comment on how they have been made aware of this.