Southampton City Council
INVESTMENT STRATEGY
2023/24

Contents

	SECTION 1 – INTRODUCTION
1.1	**Background**
1.1.1	The Authority invests its money for three broad purposes: • because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments), • to support local public services by lending to or buying shares in other organisations (service investments), and • to earn investment income (known as commercial investments where this is the main purpose). This investment strategy meets the requirements of statutory investment guidance issued by the government in January 2018 and focuses on the second and third of these categories.
	SECTION 2 - TREASURY MANAGEMENT INVESTMENTS
2.1	**Background**
2.1.1	The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to be £48M at the end of 2023/24 financial year.
2.1.2	The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.
2.1.3	Full details of the Authority's policies and its plan for 2023/24 for treasury management investments are covered in a separate document, the treasury management strategy.
	SECTION 3 - SERVICE INVESTMENTS: LOANS
3.1	**Background**
3.1.1	The Council is able to lend money to its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth. The Council does not currently have any service loans.
3.2	**Security - Loan Limits**
3.2.1	The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as in Table 1 below.

3.2.2	**Table 1 – Loans for service purposes £M**

Category of Borrower	**31.03.2022 Net showing in accounts**	**2023/24 Approved Limit**
Subsidiaries	-	2.00
Suppliers	-	2.00
Other Public Sector Bodies	-	20.00
Charities	-	0.50

3.2.3 Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

3.3 **Potential Loan Criteria & Risk Assessment**

3.3.1 The Council does not currently have any material loans but loans to subsidiaries may be considered, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity. Such loans will be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;
- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;
- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;
- A formal loan agreement is put in place which stipulates the loan period, repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund and takes appropriate account of state aid rules) and any other terms that will protect the Council from loss.

3.3.2 The Council would assess the risk of loss before entering into and whilst holding service loans. It is likely that should loans be considered in the future an external advisor would be engaged to undertake an assessment of the market and relevant credit ratings. These ratings would be closely monitored, and appropriate action taken swiftly should they change.

Should the Council consider any service loans in the future a robust procedure will be developed and reported to Council as an update to this strategy.

	SECTION 4 - SERVICE INVESTMENTS: SHARES
4.1	**Background**
4.1.1	The Council is able to invest in the shares of its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth.
4.1.2	One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. The Council does not currently have any material investment in shares nor is there any intention to do so at present. If this changed the Council would undertake a risk assessment before entering not a purchase and would establish appropriate Prudential Indicators.
	SECTION 5 - COMMERCIAL INVESTMENTS: PROPERTY
5.1	**Background**
5.1.1	The Council was able to invest in local, regional and UK commercial and residential property with the intention of making a profit that will be spent on local public services. Between 2016 and 2017, SCC implemented a strategy to invest in commercial properties with the expected return on investment being used to fund council services, known as the Property investment fund (PIF). The authority purchased 3 properties; details are shown in table 2 below. These properties are expected to generate £1.7M income in 2022/23 a return of 1.84% against the amount invested. There is no intention to purchase any further investment properties, in line with recent updated CIPFA guidance.
5.1.2	*Table 2: Property Investment Fund £M*

Property	Actual	31.03.2022 Actual		Outstanding Debt 31.03.2023
	Purchase Cost	**Value in Accounts**	**Cumulative Gain or (Loss)**	
Property 1	6.47	4.88	(1.59)	5.81
Property 2	14.69	11.64	(3.05)	13.18
Property 3	8.53	9.17	0.64	7.65
	29.69	**25.69**	**(4.00)**	**26.64**

5.1.3	In addition to the properties purchased under PIF, the council holds an extensive historic property portfolio. Information relating to purchase price and any associated debt is not held, as this is not required by local authority legislation. The fair value of all investment properties at the 31 March 2022 was £114.1M an increase of £1.0M from the year before. The Valuation and Estates section are responsible for the ongoing management and monitoring of the portfolio (including PIF) and for 2021/22 net income for the total portfolio was £6.3M compared to £5.7M in 2020/21 a net return of 5.48% against the Fair Value (5.04% in 2020/21).

5.2	**Security**
5.2.1	In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than the amount of debt currently outstanding for the asset. As can be seen from the table above the fair value assessment of these properties at the 31 March 2022 is below the purchase price, this was partly due to cost associated with the purchase (£1.79M) which, in line with the MRP policy in place at the time, was charged to revenue in 2017/18. Debt repayments are now being made on the annuity basis and debt will reduce by approximately £0.25M per annum.
5.2.2	Table 2 also shows that if the fair value for properties 1 and 2 are in line with 2021/22, they will continue to be below the outstanding debt by £2.47M but this is an improvement compared with last year at £2.66M. As this is outside of the current policy, consideration has been given to the future of these assets, bearing in mind that a disposal would be likely to incur a large financial loss to the Council. Whilst the properties are still providing a positive income yield, it makes no financial sense to dispose of the properties in the current economic climate. The Council will continue to closely monitor the situation, look for solutions to increase the value and report any further concerns through the relevant committees.
5.2.3	The Council is therefore taking mitigating actions to protect the capital invested in Property 2, whilst supporting economic growth in the City. These actions include plans within the capital programme to divide the existing unit into two smaller units, to achieve the following benefits: • Creating more marketable units for future growth and support the changing needs of businesses, • Reducing exposure to one tenant's income on such a large unit, • Improving the combined covenant strength underpinning this asset, and • Increasing the capital value of the asset above the value of outstanding debt and purchase cost. Once these works have been undertaken, a review will be undertaken to ensure that maintaining the asset is still appropriate.
5.3	**Risk Assessment**
5.3.1	The council assesses the risk of loss before purchasing and whilst holding investment property and monitors both the fair value and the return on the assets to assess the benefits of either retaining or disposing of the assets.
5.3.2	Budgeted investment income allows for voids and maintenance costs, which are reviewed as part of budget monitoring on individual properties to ensure they continue to provide the correct level of risk management.
5.4	**Liquidity**
5.4.1	Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. Therefore, to assess liquidity, the Council monitors the income stream attached to property purchases, a much more liquid asset, comparing budgets to forecasts and actuals. Since purchasing the PIF properties actual

	income has and continues to be in line with the budgeted figure and there are no current indicators to suggest that the forecast future income will not be achieved. If there is any change this would be reported as part of the revenue financial monitoring process.
	SECTION 6 - CAPACITY AND SKILLS
6.1	**Elected members and statutory officers**
6.1.1	CIPFA's Code of Practice requires the CFO to ensure that all Members tasked with Treasury Management (TM) responsibilities, including scrutiny of the TM function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Treasury training is offered to all members annually, which is undertaken by our advisors, Arlingclose. This will be part of the training offered post the May 2023 election on financial matters. Further training is also provided if the need arises, for example a change in leadership and the makeup of Governance committee. We would also arrange additional training if there was to be a material change in the Treasury Strategy, explaining the reasoning behind it, to ensure that Members understand what they are being asked to approve. For Officers the Council adopts a continuous performance and development programme to ensure staff are regularly appraised and any training needs addressed. Relevant staff also attend regular training sessions, seminars and workshops which ensure their knowledge is up to date. Details of training received are maintained as part of the performance and development process.
6.2	**Commercial deals**
6.2.1	Any future commercial investments will be subject to a detailed business case and need the relevant approvals. The Council has a robust process in place for property investment and therefore has a separate Property Investment Strategy. It sets out the scoring criteria each investment will be subjected to, including financial checks on potential tenants to evidence their financial stability and risk level. An independent valuation will also be conducted to obtain a level of assurance that the price quoted, and the rent charged were in line with the expected market rate. Once all criteria are met final agreement is required by the S151 Officer, Head of Property, the Cabinet Member for Finance & Change and the Leader of the Council. The Council has an experienced in-house estates and valuation team, who will manage the process and the day-to-day management of any investments. The use of external experts will be employed where specialist knowledge is required in the acquisition, disposal or performance management of commercial property.
	SECTION 7 - INVESTMENT INDICATORS
7.1	**Background**
7.1.1	The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure because of its investment decisions.

7.2 Total Risk Exposure

7.2.1 This indicator shows the Authority’s total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third-party loans.

7.2.2 *Table 3: Total investment exposure £M*

	31.03.2022 Actual	***31.03.2023 Forecast***	***31.03.2024 Forecast***
Treasury management investments	107.2	48.1	48.1
Service investments: Loans	0.0	0.0	0.0
Commercial Investments: PIF	26.9	26.6	26.4
TOTAL EXPOSURE	**134.1**	**74.7**	**74.5**

7.3 How Investments are Funded

7.3.1 Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as funded by borrowing. The remainder of the Authority’s investments are funded by usable reserves and income received in advance of expenditure.

7.3.2 *Table 4: Investments funded by borrowing and loan to value ratio*

Investment funded by borrowing	***2021/22 Actual***	***Loan to Value Ratio***	***2022/23 Forecast***	***Loan to Value Ratio***	***2023/24 Forecast***	***Loan to Value Ratio***
	£M	***%***	***£M***	***%***	***£M***	***%***
Commercial Investments: Property (PIF)	***26.9***	***105***	***26.6***	***104***	***26.4***	***103***

The maximum loan to value indicator is set at 100%. The 104% shown in the table demonstrates the loan outstanding now exceeds the estimated fair value, in aggregate for the 3 properties. The policy adopted states if that position should arise i.e. the value is less than the outstanding sum borrowed, then this should be reported to Council and hence this is highlighted. The authority should then look to take steps to assess the viability of holding the investment, but it is proposed for the moment that as asset values are very volatile post Covid and the Autumn Statement, that the position is monitored carefully over the next 3 months.

7.4 Rate of return received

7.4.1 This indicator shows the investment income received less the associated costs, including the cost of borrowing, as a proportion of the debt outstanding.

Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

7.4.2 *Table 5: Investment rate of return (net of all costs) %*

Investment net rate of return	***2021/22 Actual***	***2022/23 Forecast***	***2023/24 Forecast***
Property 1	***2.62***	***2.65***	***2.68***
Property 2	***2.55***	***1.91***	***1.93***

Property 3	***1.79***	***1.81***	***1.83***
Total Average Rate of Return	***2.35***	***2.05***	***2.07***