

## Commercial Investment Strategy 2023/2024

### Recommendation of the Cabinet Member for Finance and Resources

#### Report of the Director of Finance (S151)

1. That Cabinet approves:
  - (a) the Commercial Investment Strategy for 2023/24 and notes the circumstances under which Commercial Investments can be made;
  - (b) the Governance arrangements that are in place for proposing and approving Commercial Investments;
  - (c) a maximum quantum for Commercial Investments of £20 million in 2023/24;
  - (d) a maximum limit for an individual Service Investment Loan of £10 million in 2023/24; and
  - (e) that any upwards change in the amounts of the limits specified in Recommendations 1(c) and 1 (d) be delegated to the Director of Finance in consultation with the Cabinet Member for Finance and Resources.

#### Introduction

2. The County Council ('the Council') can invest its money for three main purposes:
  - **Treasury Management Investments** – when the Council has surplus cash because of its day-to-day activities, i.e. where income is received in advance of expenditure;
  - **Service Investments** – when the Council supports local public services by lending to or buying shares in other organisations; and
  - **Commercial Investments** – where the Council's main purpose is to earn investment income.
3. The Council's treasury management investments are considered as part of the Council's Treasury Management Strategy 2023/24, which is the subject of a separate report, and which meets the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services Code of Practice 2021 Edition* (the CIPFA Code).
4. The Commercial Investment Strategy 2023/24 report meets the requirements of the statutory guidance issued by the Ministry of Housing, Communities and Local Government (now referred to as Department for Levelling up, Communities and Local Government - DLUHC) in its *Guidance on Local Government Investments 2018 Edition*. It will concentrate on Service Investments and Commercial Investments i.e., the Council's non-treasury management investments. This Strategy covers Council matters only and does not include Staffordshire Pension Fund investments, which are subject to separate governance arrangements.

5. With effect from 26 November 2020, as a condition of accessing the Public Works Loan Board (PWLB), Local Authorities will be asked to confirm that there is no intention to buy investment assets, primarily for yield, in the current or next two financial years. As there is no intention by the Council, to buy Commercial Investments purely for yield, nor to fund them through the PWLB, then this should not be cause for concern. Commercial Investments for the Council will remain in line with the acceptable use of PWLB monies, which includes investment for:
- Service Delivery;
  - Housing;
  - Regeneration;
  - Preventative Action; and
  - Refinancing / Treasury Management activity (including to replace 'internal borrowing').
6. CIPFA released a new version of the Prudential Code in December 2021 and the provisions in the code applied with immediate effect. The points affecting this report are as follows:
- A Local Authority must not borrow to invest primarily for financial return;
  - Commercial Property – makes clear any historical asset base is not impacted and that plans to divest should form part of an annual review and be reported as part of the Treasury Management and Capital Strategies;
  - Definition of Investment – separate categories for Treasury Management Investment, Service Investment and Commercial Investment.
- The Council has not, nor plans to, contravene any provisions in the revised code.

### **Treasury Management Investments**

7. The Council typically receives income in cash (e.g., from precepts and grants) and 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 long-term borrowing decisions can lead to a cash surplus which is invested in accordance with the Treasury Management guidance from CIPFA.
8. The contribution that treasury investments make to the objectives of the Council is not focussed purely on generating investment income. Whilst yield is an important consideration, it is in support of effective treasury management activities and is, therefore, secondary in nature to the security and liquidity of those investments.
9. Details of the Council's policies and plans for treasury management activities for 2023/24 are covered in the Treasury Management Strategy, which includes the Annual Investment Strategy.

### **Service Investments**

10. The core function of the Council is to deliver statutory and local public services to local residents and ensure the general wellbeing of the county and its residents. Indeed, the Council's own Vision is for an innovative, ambitious and sustainable county, where everyone has the opportunity to prosper, be healthy and happy.

11. Service Investments can be broadly defined as any investments made to support delivery of statutory and local public services, and the details of these are contained within the Capital Strategy for 2023/24, which is also the subject of a separate report. However, in terms of the DLUHC guidance on Service Investments, these are more specifically defined as Loans or Shares.

### Loans

12. The Council can lend money, to third parties, to support local public services and stimulate economic growth.
13. Previously, the Council has lent £150,000 to Nexxus Trading Services Ltd, a company wholly owned by the Council to provide social care services for older people and those with disabilities. The loan has now been repaid to the Council in full.
14. Whilst the loan to Nexxus was to an organisation with which the Council has strong links, if the Council wanted to make a loan to local organisations, such as suppliers, local businesses, local charities, housing associations, local residents, or its employees, it would need to ensure the loan meets service delivery objectives or fulfils one of its roles as a local authority.
15. The principal risk of making Service Investment loans is that the borrower may be unable to repay the principal lent or the interest due. To limit this risk, the Council will need to consider setting upper limits for each category of borrower and potentially a maximum single loan amount. To provide some flexibility, it is proposed that the maximum single loan amount for 2023/24 be set at £10 million. Consideration will also need to be given to limits by category of borrower and any single loan amount limits within those categories. Proportionality and the covenant strength of the borrower will also need to be considered e.g., a local business relative to an employee.
16. Any request for a service loan will be considered on its own merits. The Council will need to undertake a full risk assessment before making a service loan and continue to assess the covenant strength of the borrower, during the full term of the loan. The risk assessment will consider, but not be limited to, the following:
- Assessment of the market and the borrower including:
    - i. the nature and level of competition in that market;
    - ii. how the market and borrower's needs will evolve over time;
    - iii. any barriers to entry or exit to that market;
    - iv. any ongoing investment needs for the borrower; and
    - v. any State Aid considerations.
  - Whether and how the Council will use external advisors.
  - How the quality of advice from the external advisor will be monitored and maintained.
  - To what extent credit ratings have been used.
  - Where credit ratings are used, how 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.
  - Any security that might be required.

17. Where service loans are made, the Council will make every reasonable effort to ensure the full amount lent is repaid and will have appropriate credit control arrangements in place to recover overdue payments. Accounting standards still require the Council to set aside loss allowances for any likelihood of non-payment. The Council will report the balance owed less any loss allowance in its statement of accounts.

### Shares

18. The Council can invest in the shares of a third-party organisation to support local public services and potentially stimulate local economic growth.
19. Prior to the revised guidance being issued, the Council already owned 49% of the shares in Entrust and Capita Business Services Limited (a subsidiary of Capita Plc) owned the remaining 51%. Entrust primarily provide education support services to local schools, so this investment clearly aligns itself to the Council's service delivery objectives i.e., the running operations of schools in Staffordshire.
20. The main risk of investing in shares is that they may fall in 'market value', meaning that the initial outlay may not be recovered if there was ever a need to sell the shares. The Council's shares in Entrust had a nil value at 31 March 2022; however, the investment continues to contribute to the Council's service delivery objectives.
21. To try to limit this risk in the future, and as part of this strategy, the Council could consider setting upper limits on the amount that can be invested in each category of shares. However, no limits are being suggested for 2023/24, as any investment proposal will need to be considered fully prior to being presented to Cabinet for their decision.
22. Any request to invest in the shares of a company for service purposes will be considered on its own merits. The Council will need to undertake a full risk assessment before making such an investment and will also need to continue to assess the financial strength of the company whilst it remains invested in those shares. The risk assessment will consider, but not be limited to, the following:
- Assessment of the market and the investment company including:
    - i. the nature and level of competition in that market;
    - ii. how the market and the investment company's needs will evolve over time;
    - iii. any barriers to entry or exit to that market; and
    - iv. any ongoing investment needs for the company.
  - Whether and how the Council will use external advisors.
  - How the quality of advice from the external advisor will be monitored and maintained.
  - To what extent credit ratings have been used.
  - Where credit ratings are used, how 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.
23. For liquidity purposes, both types of Service Investments fall outside the remit of the Capital Strategy; therefore, the Council will need to put in place procedures to determine how it will stay within any Approved Limits and the maximum investment duration permitted for investments. For 2023/24, with very few Service Investments

anticipated, it is proposed that this be incorporated into the risk assessment of the individual loan or share proposals, which will be overseen as part of the Governance arrangements described later in this report.

## Commercial Investments

24. Under current DLUHC Guidance, the Council is not permitted to make Commercial Investments with the intention of making a profit or generating revenue income.

### Property Commercial Investments

25. In November 2019, CIPFA published its informal guidance on 'Prudential Property Investment', highlighting concerns over the recent and rapid expansion of commercial property purchases and its relationship with the statement in the Prudential Code 'that local 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'.
26. HM Treasury have expressly prohibited PWLB lending for commercial purposes and furthermore, have put measures in place to prevent such activity. The Council does not have any such Commercial Investments in property. CIPFA has also revised the Prudential Code to further strengthen the position, and this now prevents authorities from borrowing to invest primarily for financial return.
27. Whilst there has been some political challenge about borrowing to invest outside of the local area, more acceptable would be investment in property, within the local area, particularly where it supports the provision of services. Previously, this type of investment activity may have been funded using surplus reserves or external borrowing for capital purposes, where long term reserves were not available. However, due to the recent Prudential Code revisions this type of investment activity is prohibited, if there is a need to utilise PWLB funding.
28. Irrespective of location, service purpose or method of funding, any property investments would be subject to the same risk assessment process as other Commercial Investments. This will include, but not be limited to, the following:
- Assess the market and the investment specifics including:
    - i. the nature and level of competition in that market;
    - ii. how the market and the investment will evolve over time;
    - iii. any barriers to entry or exit to that market; and
    - iv. any ongoing investment needs for the asset class.
  - Whether and how the Council will use external advisors.
  - How the quality of advice from the external advisor will be monitored and maintained.
  - What other sources of information are used to assess and monitor risk.
29. Property has additional risk considerations in terms of valuation, income and liquidity:
- The market and accounting valuations may be lower than the purchase cost (including taxes and transaction costs) and this may have revenue account consequences;
  - Rental income is dependent on having a tenant and the ability of that tenant (covenant) to make payment; and

- Properties can be difficult to sell and convert to cash at short notice, especially in certain market conditions.

### Other Commercial Investments

30. Under the wider Commercial Investment opportunity, the Council can also invest in non-property related assets such as Equities, Bonds, Land, and Infrastructure. Within these asset classes, there are different sub-sectors and they are structured in multiple different investment forms and legal structures, such as direct investments, unitised investment vehicles and limited partnerships.

### Loan Commitments and Financial Guarantees

31. Whilst not investments per-se, as no money has exchanged hands, loan commitments and financial guarantees are referenced for completeness, as they carry similar risks to investments.

### Commercial Investment Panel

32. During 2019/20, the Council formed a Commercial Investment Panel ('the Panel') consisting of senior officers at the Council and chaired by the Director of Finance. The Panel meet periodically, and as necessary, to consider Commercial Investment opportunities and how they might be aligned with investment in the county and the public services the Council needs to provide.
33. The Panel agreed the remit and scope of its Commercial Investment Strategy. This included discussions regarding:
- The initial investment quantum;
  - The likely investment asset class and sector;
  - The favoured geographic location of the investment; and
  - The target for income and growth required from the investment.
34. To date, the Council has not made any Commercial Investments and before doing so, detailed consideration of any proposed investments will be reviewed in accordance with the Governance framework described later in this report (see **Paragraph 40**).

### **Quantum, Proportionality and Diversification**

35. Guidance recommends that if a Local Authority plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, then it must show the extent of that dependency as part of this report. Contingency plans if it fails to achieve the expected net profits should also be outlined.
36. Whilst the Council does have Service Investments in the form of shares, and whilst the Council is open to reviewing its approach to determine whether income from investments can be improved, the Council is not currently, nor does it plan to become, dependent on profit generating investment activity to achieve a balanced revenue budget. However, it is considered good practice and good risk management to consider the Council's exposure to Commercial Investments in terms of total exposure, single investment exposure and diversity of investments.

37. In respect of Commercial Investments, it is proposed that in 2023/24 total exposure should be capped at £20 million p.a. Whilst it would be beneficial to also limit the amount on any single investment, thus forcing diversification, (i.e., a £5 million single investment limit would mean a minimum of 4 investments) it is considered impractical to do so in the early stages of building up any Commercial Investment portfolio. However, this will need to be kept under review.

### **Borrowing in Advance of Need**

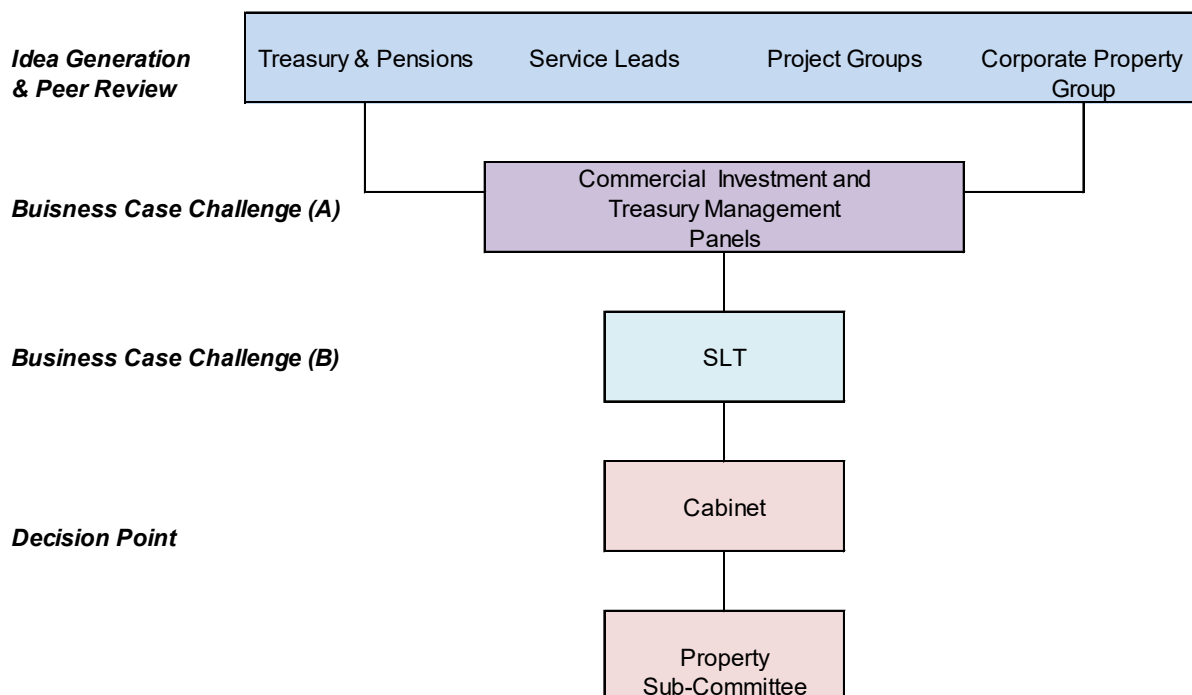
38. As referred to previously, Government guidance states that local authorities must not borrow more than, or in advance of, their needs, 'to profit from the investment of the extra sums borrowed'. To date, the Council has not borrowed in advance of need for this purpose. When the Council did borrow in advance of need, or if it is likely to need to do so in the future, then this would only be to fund the borrowing requirement for the capital programme; particularly if future borrowing rates were expected to increase.
39. Alongside the data currently required by the Debt Management Office, to provide a Local Authority with access to PWLB funding at the 'certainty rate', there is also a requirement to submit additional data and provide assurance from the S151 Officer about the purpose of any Borrowing in Advance of Need. Should it be ascertained that such borrowing is being used to invest primarily for yield, and there has been misuse of the PWLB, then penalties could include:
- a request that the Council unwinds problematic transactions;
  - suspension of access to PWLB;
  - repayment of loans with penalties; or
  - a wider ranging sanction relating to a government review of the local government borrowing and investment framework.

### **Governance, Capacity, Skills and Culture**

40. The Council will ensure that Elected Members and Senior Officers involved in the investment decision making process have the appropriate capacity, skills and information. Those involved in the investment decision making process should;
- take informed decisions about whether to enter into a specific investment;
  - assess individual investments in the context of the strategic objectives and risk profile of the Council; and
  - understand how their investment decisions can change the risk exposure of the Council.
41. Elected Members and Senior Officers involved in negotiating commercial deals for the Council will be aware of the core principals of the prudential framework and of the regulatory regime within which the Council operates. Whilst much of this has been covered in the body of this report, other things, such as procurement regulations will also need to be considered.
42. Whilst idea generation will not be exclusive, the Council will ensure that it has Corporate Governance arrangements in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the Council's corporate values. The following chart illustrates how this will work within the current Corporate Governance arrangements albeit it is recognised that this may need to change as the Council's awareness and involvement in Commercial

Investment activity evolves. The Scheme of Delegation, and any relevant sub-schemes, may also need to change to reflect any new arrangements going forward.

### Commercial Investment Governance Framework



43. Investment Advisors will be used in the Governance process, not only to bring relevant investment expertise and information but also to introduce independent challenge into the process. The cost of using Advisors will need to be considered in any analysis of forecast net investment returns.
44. A Business Case, in an agreed form, but covering such details as that provided in **Annex A** will need to be submitted by the initiator of the Investment to facilitate peer review and challenge. As well as a descriptor of the Commercial Investment opportunity, the Business Case will need to demonstrate its alignment to the Council's Vision and Priorities as well as any service delivery considerations. Key areas of the Business Case will include and demonstrate:
- Details of Investment
  - Background (including the Service Objective being fulfilled)
  - Due Diligence Undertaken
  - Financial and Legal Implications
  - Risk and Risk Management
45. The business case will be submitted to the Commercial Investment Panel for consideration to be put forward into the Council's formal decision-making process which, depending on the type of approval required, will go into the committee cycle.

### **Investment Indicators**

46. As part of its routine reporting, and in addition to the various investment limits the Council should also consider setting quantitative indicators to assess its Commercial Investment decisions. As a minimum these should include the Council's Total Risk Exposure, Investment Funding and the Net Investment Rate of Return. Again,



indicators will need to be developed as part of working practices should the Council's Commercial Investment activities gain momentum. An illustration of how these Indicators might be constructed is provided in **Annex B**.

**Rob Salmon**  
**Director of Finance**

### Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2021)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2021)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)
6. Localism Act 2011–Guidance on the General Power of Competence in sections 1 to 6.

### **Contact Details**

**Report Author:** Justin Madden  
**Job title:** Investment Accountant  
**Telephone Number:** 01785 278146  
**Email Address:** [Justin.madden@staffordshire.gov.uk](mailto:Justin.madden@staffordshire.gov.uk)  
**Location:** Treasury and Pensions, 1 Staffordshire Place

**Report Commissioner:** Melanie Stokes  
**Job Title:** Assistant Director for Treasury and Pensions  
**Telephone No.:** 01785 276330  
**E-Mail Address:** [melanie.stokes@staffordshire.gov.uk](mailto:melanie.stokes@staffordshire.gov.uk)

**Annex A****STAFFORDSHIRE COUNTY COUNCIL  
COMMERCIAL INVESTMENT BUSINESS CASE****Illustration of areas to be considered****A Details of Investment**

1. Name of Investment
2. Proposed Investment / Price £
3. Brief Description of Investment
4. Form and Legal Structure of Investment
5. Forecast Net Investment Return (Capital and Annual Income)
6. Investment Period
7. Investment Management Fees / Developer Profit

**B Background**

1. Reason for proposing Investment
2. Service Objective fulfilled
3. Social Impact
4. Funded from
5. Fit with other Investments / Strategy (Diversification)

**C Due Diligence Undertaken**

1. Investment Advisors / Managers
2. Structure of Company and People involved in the Investment
3. Process for Investment decision making
4. Underlying Investment Philosophy
5. Performance of previous similar Investments
6. Price

**D Financial Implications**

1. Yield
2. Capital / Income Return Targets
3. Source of Funding
4. Borrowing in Advance of Need
5. Commitment, drawdown, investment periods
6. j-curve
7. Payback period
8. Exit Penalties
9. Minimum Revenue Provision implications
10. International Financial Reporting Standard 9 – Financial Instruments
11. Fees

**E Environmental, Social and Governance Implications**

1. Positive / Negative factors
2. Legality

**F Risk & Risk Management**

1. Security Risk
2. Investment Risk
3. Liquidity Risk
4. Development Risk
5. Counterparty Risk
6. Reputational Risk
7. Compliance Risk
8. Operational Risk
9. Regulatory Risk
10. Interest Rate Risk
11. Market Risk
12. Currency Risk
13. Non-Systematic Risk (Diversification)

**G Legal Implications**

1. Form and Structure of Investment
2. Documents
3. Anti-Money Laundering / Know Your Customer
4. Indemnities
5. Conflict of Interest

**H Procurement Implications**

1. Procurement Route followed
2. Exemptions received

**Governance**

Peer Review undertaken:

Comments:

Business Case Challenge (A) TMP / CIP undertaken:

Comments:

Business Case Challenge (B) SLT undertaken:

Comments:

Recommendation to Cabinet / Property Sub- Committee:

**Annex B****COMMERCIAL INVESTMENT INDICATORS****Total Risk Exposure**

This demonstrates the Council's total exposure to potential investment losses.

<b>Total investment exposure</b>	<b>31 March 23 Actual £m</b>	<b>31 March 24 Forecast £m</b>	<b>31 March 25 Forecast £m</b>
Treasury Management Investments			
Service Investments: Loans			
Service Investments: Shares			
Commercial Investments:			
<b>TOTAL INVESTMENTS</b>			
Commitments to lend			
Guarantees issued on loans			
<b>TOTAL EXPOSURE</b>			

**Investment Funding**

The Council's investments may be funded by borrowing and /or the use of reserves, capital receipts, grants, developer contributions etc. These will be itemised appropriately.

**Net Investment Rate of Return**

This indicator shows the investment income received less the associated costs (including the cost of borrowing if appropriate), as a proportion of the sum initially invested. Under the local government accounting framework, not all gains and losses affect the revenue account in the year they are incurred.

<b>Net Investment Rate of Return</b>	<b>2022/23 Actual</b>	<b>2023/24 Forecast</b>	<b>2024/25 Forecast</b>
Treasury Management Investments			
Service Investments: Loans			
Service Investments: Shares			
Commercial Investments:			
<b>ALL INVESTMENTS</b>			