

EAST HERTS COUNCIL

EXECUTIVE - 5 NOVEMBER 2013

REPORT BY THE EXECUTIVE MEMBER FOR FINANCE

DEVELOPING AN INVESTMENT STRATEGY FOR EAST HERTS

WARD(S) AFFECTED: ALL

Purpose/Summary of Report

- This report recommends a set of principles for developing an Investment Strategy for East Herts that seeks to address the need to identify new and additional sources of revenue income over the medium to long term. This is in the context of reducing revenue streams from traditional sources including Central Government Grants.

<u>RECOMMENDATIONS FOR EXECUTIVE:</u> that:	
(A)	the policy principles for property investment as detailed in Section 3 of this report be approved;
(B)	the draft outline of the timetable for action be noted and that a further progress report be submitted to a future Executive meeting; and
(C)	the requirement for additional resources to support the development of this policy that will be funded from the 2013/14 planning contingency be noted.

1.0 Background to Developing an Investment Strategy

1.1 With central government funding for local authorities on a clear downward trend in both the short and medium term there is a growing need for East Herts to identify new and/or additional sources of revenue income. While the organisation will continue to find new efficiencies and more joined up and innovative ways of working, greater self reliance in funding will be required if many key services are to be secured.

- 1.2 EHDC does already have a number of car parks and small freehold properties that provide an income to the council. However, there has never been a policy of actively acquiring properties for investment purposes and the lack of any significant land holdings is a limiting factor.
- 1.3 The Council also receives income through locally set fees and charges for some services which are considered on an annual basis to ensure that appropriate cost recovery and/or generation of surpluses are considered, but this income generation is unlikely to increase significantly which is why new avenues need to be considered.
- 1.4 One means of contributing to that self sufficiency could be via an investment strategy utilising some of the council's capital currently held in money market accounts yielding low levels of return, to instead invest in other assets to deliver an enhanced income.
- 1.5 Local Government Finance Rules impose their own set of constraints on what the Council can, and can't do and importantly the council's policy and priorities will also shape our approach. The Council must be satisfied that 3 main criteria are considered and balanced, whatever investments it undertakes. These are liquidity, risk and yield.
- 1.6 Our investment strategy will need to be clearly articulated and understood in order to ensure that the council puts in place appropriate governance arrangements to facilitate a sound investment programme. Consensus thus far is that creating the right legal structure is potentially difficult and complex but the underlying principle of using capital to generate income is acceptable.
- 1.7 There are a number of legal structures that could be employed. These could include Joint Ventures and / or Special Purpose Vehicles. A simple "definition" of these two types of structures are as follows:
 - Joint Venture: A joint venture is a contractual business undertaking between two or more parties based on a single business transaction. Individuals or companies choose to enter joint ventures in order to share strengths and minimize risks.
 - Special Purpose Vehicle: This is a legal entity created for a limited purpose. They can be used for a number of purposes

including the acquisition and/or financing of a project, or the set up of a structured investment vehicle. They are usually used because they are free from any pre-existing obligations and debts, and are separate to the parties that set them up for accountancy purposes.

1.8 Having sought early expert advice the proposition is that East Herts commits to develop a balanced portfolio which provides a spread of cash and property based investments which will optimise income in the context of balanced approach to risk. The advice that has already been sought covers initial information around potential financial and legal considerations that must be made prior to final investment decisions, but it will be necessary to take more detailed technical advice once policy decisions become clearer. This advice has formed the basis of information contained within this report.

1.9 East Herts currently has available capital sums available for investment in excess of £60m, the majority of which is currently in short- term money markets. Initial thoughts are that a portfolio should be developed so that there is a balanced portfolio across the following 3 areas:

- Continued investment in the money market
- Investment in property funds
- Investment be made available for purchase of private housing or commercial property potentially through joint venture activities with third parties

1.10 The balance of how much is invested in each of the three areas will depend on a number of factors and is likely to change over time. Consideration will need to be given to the balance between the need to maintain readily accessible funds to support the everyday activities of the Council, being able to take best advantage of higher rates of return and recognising that some forms of investment will take longer to make decisions about than others.

2.0 Risks and advantages of Property Investment

2.1 Property can provide a secure investment that delivers a reasonable return on capital. As with all asset classes there are risks including:

- Risk of 'bubbles' or unrealistic asset prices

- Depreciation or loss of value due to economic conditions

2.2 Property has specific risks including:

- Low liquidity and flexibility
- Greater exposure to economic, cultural and technological changes
- Over / under supply within local markets
- Physical / structural issues with buildings
- Void periods (no return but continued outgoings)

2.3 The advantages of property as an asset class are:

- Ownership of a tangible asset at the end of the investment (either the building or the land the building sits on upon) – the ‘reversionary interest’
- Lease arrangements provide one of the most secure legal contracts and surety of income
- The opportunity to negotiate more favourable terms in response to improvements in the market
- Returns of on average above bank interest rates

2.4 As part of a balanced investment portfolio, property will often sit alongside bonds in providing a relatively secure (and often low yielding) investment asset.

3.0 Establishing Member Priorities and Ambitions

3.1 In creating the correct structure to manage investments, there are important considerations that need to be made, particularly the form and size of investments to be made and where they are to be made too. The overriding principle has to be that the residents of East Herts are the beneficiaries of any investment programme.

3.2 An East Herts commercial investment portfolio will need to be run as a purely commercial initiative delivered free from day to day interference. Adopting a ‘commercial’ approach does not mean an unethical approach. All property can be managed in a way that is sympathetic to the local area and in accordance with national and local planning policies and guidelines.

3.3 Any imposition of restrictions on uses, users and using property to drive wider social objectives will directly impact upon the ability of the authority to maximise income from property assets. It is important therefore that the Council’s Investment Strategy and

Investment Criteria is fully aligned to Council Policies in advance of further investments taking place

3.4 The following policy principles are therefore proposed:

- An investment portfolio should be developed over time in a range of general property and investment funds. Investment can be made UK wide and will not be restricted to investments within the district only.
- For the foreseeable future the council should be seeking to maximise a secure income from its investment portfolio
- Enhanced revenue income from investments must be used to benefit the residents of East Herts, in particular to protect wherever possible, vital services being reduced
- While local investment may be undertaken with place making / regeneration outcomes, this will not override the need to generate a good level of secure return
- Investment in housing for the private rental market or other commercial property would be an acceptable outcome. This may have to be delivered via a Special Purpose Vehicle or a Joint Venture or other appropriate arrangement. The Council accepts that the most appropriate governance framework must be used, following due diligence work by officers.
- The Authority should not be limited to acquiring investments in its own right

4.0 Next Steps to Creating East Herts Property Investment Portfolio

4.1 This report is the first step in establishing the principles and policy for creating an investment portfolio. Further advice from experts will need to be sought to ensure that the Council has undertaken due diligence in balancing the 3 key components for investment decisions on liquidity, risk and yield.

4.2 Members have been asked to agree the policy principles in Section 3 of the report which will then establish the framework in which future decisions will be taken.

4.3 If these principles are agreed then the next steps will be as follows:

Action	Who	When
Detailed assessment of our current Property Portfolio to establish our current rate of return on our assets	Asset Management Team	November 2013
Consider current Money Market Investments and potential Property Funds	Investment Panel supported by our independent financial advisors	November 2013
Procure external advice on establishing investment strategy for purchase of investment property	Director of Finance and Support Services	December 2013
Consider financial implications of investment strategy on the Medium Term Financial Plan	Director of Finance and Support Services	To be included in budget setting process for 14/15

- 4.4 The assessment of our current Property Portfolio will provide a benchmark of our current rate of returns and assist with establishing what our potential future returns should be. This will be a more detailed breakdown than the way we currently consider our portfolio.
- 4.5 Although initial advice has been sought at a more general level, and has been used for the basis of this paper, external advice will be necessary to establish more specific technical advice around our investment strategy for the purchase of future investment property. A brief is in development to procure services from specialist advisors and develop in-house resources to be able to establish our strategy that will include support and guidance on the following issues:
- Determining what our investment criteria will be. A typical set of criteria are included as **Essential Reference Paper 'B'** to give an idea of the likely considerations that would be made.
 - Recommendations on approach towards investment property including the type of property available for investment

- Recommendations on alternative investment vehicles and the suitability for running these at East Herts
- Measurement of performance of the portfolio and arrangements for consideration around acquisition and disposal of assets
- Understanding the different possible governance arrangements and their implications for decision making and financial impacts
- Support arrangements for managing an expanded portfolio

4.6 To be able to initiate this programme, additional resource will be required to ensure that we undertake proper due diligence work. In the initial period, this will need to be funded from the Planning Contingency budget in 2013/14. It is expected that on-going revenue costs will need to be considered as part of the overall calculation of return on investments when assessing Return on Investments.

5.0 Implications/Consultations

5.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers

None

Contact Member: Cllr Michael Tindale – Executive Member for Finance
michael.tindale@eastherts.gov.uk

Contact Officer: Adele Taylor – Director of Finance and Support Services, ext 1401
adele.taylor@eastherts.gov.uk

Report Author: George A. Robertson – Chief Executive and Director of Customer & Community Services
george.a.robertson@eastherts.gov.uk

Adele Taylor – Director of Finance and Support Services
adele.taylor@eastherts.gov.uk