

INVESTMENT STRATEGY 2021/22

1. INTRODUCTION

- 1.1 The Investment Strategy is a requirement of the Ministry for Housing, Communities and Local Government's (MHCLG) *Statutory Guidance on Local Government Investments*. The MHCLG Guidance also requires local authorities to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) publications of *The Prudential Code for Capital Finance in Local Authorities* and *Treasury Management in the Public Services* which both complement it.
- 1.2 The Council 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).
- 1.3 The main purpose of the strategy is to identify the level of the Council's service and commercial investments and to set risk management parameters around these. It is based on the authority's existing and planned service-related and commercial investments and is consistent with the General Fund Medium Term Capital Programme due to be approved by full Council on 24 February 2021.
- 1.4 During 2020 the Council created the Otterpool Park Limited Liability Partnership (LLP) as a wholly owned subsidiary to deliver the Otterpool Park development. Otterpool Park will provide up to 10,000 much needed new homes over a 30 year period, creating significant economic benefits to the district. The Council, as principal land owner, also expects to gain a financial return from its investment in the development.
- 1.5 Cabinet approved the initial business plan for the LLP on 20 January 2021. This will require the Council making an investment of about £70m in the LLP through a combination of equity, in the form of a capital contribution, and loan funding and work is currently taking place to determine the optimum mix for this. For the purposes of this strategy, it has been assumed that funding will be 10% equity and 90% loan. However, a tolerance has been built into the proposed investment limits within the strategy that allows the equity to increase to 20% with the loan funding reducing to 80%. The Council will receive a market rate of interest on the loans advanced to LLP. Over time the Council expects to receive returns on its equity investment in the LLP largely generated from the sales of land to housing developers and this will be governed by the terms of the Members' Agreement.

2. TREASURY MANAGEMENT INVESTMENTS

- 2.1 The Council 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 and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the CIPFA. The balance of treasury management investments is expected to fluctuate between £15m and £35m during the 2021/22 financial year.
- 2.2 **Contribution:** The contribution that these investments make to the objectives of the Council is to support effective treasury management activities. These investments also contribute an income stream to support the General Fund budget position annually.
- 2.3 **Further details:** Full details of the Council's policies and its plan for 2021/22 for treasury management investments are covered in a separate document, the Treasury Management Strategy Statement (TMSS), approved by Cabinet on 20 January 2021 as part of the budget process for 2021/22. The approved TMSS will be published on the Council's website.

3. SERVICE INVESTMENTS: LOANS

- 3.1 **Contribution:** The Council can lend money to its subsidiaries, its charities where the council is the trustee, its external service providers, local residents and its employees to support local public services and stimulate local economic growth. In the future the Council may also lend money to joint ventures it decides to enter into to help deliver its major corporate investment initiatives. Examples of loans the Council makes are shown in the table below:

Table 1 – Example of Loans Made for Service Investments

Organisation	Relationship	Purpose	Service Objective
Oportunitas Ltd	Housing and Regeneration subsidiary company	Primarily for the acquisition of residential property for rent	Provision of good quality homes for rent Generate additional revenue stream for the General Fund
Folkestone Parks and Pleasure Grounds Charity	Council is the trustee	Refurbishment and replacement of Beach Huts	Improve the appearance of the district and to improve the financial resilience of the

			Charity through additional income generated
Local property owners	Jointly funded empty homes initiative with Kent County Council	Interest free loans to property owners to bring empty properties across the district back in to residential use	Bringing empty residential properties back into use and the provision of additional good quality homes
Otterpool Park LLP	Otterpool Park Delivery Vehicle subsidiary company	Delivery of the Otterpool Park Garden Town development	Provision of new homes, generate economic benefits and provide a financial return to the Council

- 3.2 **Security:** 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 follows:

Table 2 - Loans for service purposes in £ millions

Category of borrower	31.3.2020 actual			2021/22
	Balance owing £m	Loss allowance £m	Net figure in accounts £m	Approved Limit £m
Subsidiary – Oportunitas Ltd	4.308	(0.169)	4.139	7.0
Subsidiary – Otterpool Park LLP	-	-	-	62.4
FPPG Charity	-	-	-	0.6
East Kent Housing	0.278	-	0.278	-
Local residents/landlords (Housing)	3.634	-	3.634	3.5
TOTAL	8.220	(0.169)	8.051	73.5

- 3.3 The approved limits for 2021/22 not only include the estimated amounts to be lent in the year but also provide for any accrued interest and future loan commitments within the loan agreement.
- 3.4 The proposed loan limit in 2021/22 for Oportunitas Limited, the Council's wholly owned housing and regeneration company, includes the additional loan of

£2.47m approved by full Council on 28 February 2018. This loan is expected to fully utilised during 2022/23 in line with the latest approved business plan for the company.

- 3.5 The proposed loan limit for Otterpool Park LLP assumes the Council will provide loan funding of up to 90% from the budget provided for the Otterpool Park delivery within the Medium Term Capital Programme. Expert legal advice has been commissioned to ensure the loan to the LLP provides the Council with the optimum level of security to mitigate against the risk of default.
- 3.6 Accounting standards require the authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. No loss allowance has been made for the loans made to local property owners as the majority of these have been secured against property with a low risk of default. However, the authority is required to keep the position under review and the figures for loans in the Council's statement of accounts for 2020/21 onwards will continue to be shown net of any loss allowance made if applicable. The authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.
- 3.7 The loan to East Kent Housing has been written off in 2020-21 following the winding up of the organisation in late 2020.
- 3.8 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding service loans. This includes:
 - 3.8.1 Ensuring the authority has the legal power to make the loan to the entity in the first place.
 - 3.8.2 Assessing loan applications against the type of market the entity is operating and competing in:
 - i) Loans to the Council's subsidiary company, charities where it is the trustee, joint ventures or external service providers require a business case and, possibly, business model to be prepared in advance. This needs to demonstrate the entity's long term financial viability, its ability to meet the loan repayment terms and also the internal governance arrangements in place to support their operations. The entity also needs to demonstrate how it will evolve over time against both market conditions and its customer needs. The entity needs to identify any ongoing or future investment requirements to support it over the term of the loan. The authority's loan agreement may require the entity to provide regular performance information to enable an assessment to be made of their ability to continue to meet its terms and conditions. Unless otherwise agreed, loans made are secured against the property or other assets of the entity to help mitigate the risk of default.
 - ii) Loans to local property owners for housing improvements schemes are made in accordance with the criteria of the specific scheme agreed by the Council. All previous and existing housing improvement schemes offer interest free loans (soft loans) with the requirement that the principal sum is repaid to the authority at an agreed trigger point such as after an agreed

period of time or when the property is eventually sold. Loans are secured as a charge against the property to help mitigate the risk of default.

- 3.8.3 External advisors can be used to support the Council in assessing investment opportunities and preparing loan agreements. This can include advising on investment options appraisal, business plan or case submissions, relevant commercial lending terms, compliance for State Aid, taxation and other statutory issues and reporting obligations for the borrower.
- 3.8.4 The Council has established procurement and contract management procedures to appoint and monitor the performance of external advisors it uses. This can involve;-
- interviewing potential consultants to gain a better understanding of their breadth of experience and knowledge in the specific area,
 - liaising with other local authorities through established groups and channels to discuss the suitability of consultants being considered where it is known they have been used before,
 - focusing advice on larger firms with the breadth and depth of expertise to minimise risk, and
 - utilising our own professional judgement to consider the advice received.
- 3.8.5 Credit ratings are not currently applicable as part of the assessment process for checking the financial status of entities or individuals who apply for a loan. This may alter if the nature and scope of loans made was to change in the future.
- 3.8.6 The Council may require other sources of information to help assess the suitability of the entity requesting a loan such as financial accounts or a bank reference.

4. SERVICE INVESTMENTS: SHARES AND OTHER EQUITY

- 4.1 Prior to the current financial year, the Council invested in share equity for Oportunitas Limited. From 2020/21 this has expanded to include the proposed equity investment, as a capital contribution, in Otterpool Park LLP outlined in section one, above. In the future the Council may also acquire shares in either other subsidiaries companies it may choose to establish or joint venture companies it decides to enter into to help deliver its major corporate investment initiatives.
- 4.2 **Contribution Oportunitas Limited:** The Council's investment in the shares of Oportunitas supports its operational trading activities including its acquisition of residential property to increase the supply of good quality housing for rent to local people. No dividend return is expected in the medium term from this investment, however the council's overall investment in Oportunitas provides an additional revenue stream to the General Fund.
- 4.3 **Contribution Otterpool Park LLP:** The Council's equity investment in Otterpool Park LLP, as a capital contribution through the Members' Agreement, support its operational activities to act as the Master Developer for the proposed

scheme. The LLP's main income stream will be from selling serviced parcels of land to housing developers and this will provide the opportunity to make a return to the Council. No return is expected to be received over the first five years of the scheme.

- 4.4 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows.

Table 3 - Shares and Capital contributions held for service purposes in £ millions

Category of company	31.3.2020 actual			2021/22
	Amounts invested £'m	Gains or losses £'m	Value in accounts £'m	Approved Limit £'m
Subsidiary – Oportunitas Ltd	1.789	(0.489)	1.300	4.91
Subsidiary – Otterpool Park LLP	-	-	-	13.75
TOTAL	1.789	(0.489)	1.300	18.66

- 4.5 The approved limit for 2021/22 includes;

- i) the increase in share equity of £4.43m approved by full Council on 28 February 2018 as part of its future strategy for Oportunitas, and
- ii) the proposed equity in Otterpool Park LLP being a maximum of 20% of the agreed total equity and loan funding package, outlined in section one, above.

- 4.6 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding shares of its subsidiaries or joint ventures. This includes:

- 4.6.1 Ensuring the authority has the legal power to acquire the share capital or make the equity investment in the entity in the first place.
- 4.6.2 Preparing a long term business case and business model for the company identifying the level, structure and time scale of the investment required to enable it to become financially viable and sustainable and provide the authority with an appropriate financial return
- 4.6.3 Requiring the company to develop and maintain a business plan outlining how it will meet the objectives of the authority as shareholder including identifying associated risks, including market conditions, and measures to mitigate these.
- 4.6.4 Requiring the company in the event it was to cease trading or become insolvent to dispose of its assets and transfer the net receipt to the authority or transfer the assets to the control of the authority itself, to help mitigate the risk of financial loss.

4.6.5 Using external advisers if required to support the authority in preparing its business planning and modelling to support the creation and development of the company and also structure the shareholder agreement.

4.6.6 Using the authority's established procurement and contract management procedures to appoint and monitor the performance of external advisors it uses. This can involve;-

- interviewing potential consultants to gain a better understanding of their breadth of experience and knowledge in the specific area,
- liaising with other local authorities through established groups and channels to discuss the suitability of consultants being considered where it is known they have been used before,
- focusing advice on larger firms with the breadth and depth of expertise to minimise risk, and
- utilising our own professional judgement to consider the advice received.

4.6.7 Credit rating checks are not applicable as a risk assessment check to support the authority's investment in its wholly owned subsidiary company. This may alter if the nature and scope of the Council's acquisition of share capital made was to change in the future.

4.7 **Liquidity:** The Council's equity investments in Oportunitas Limited and Otterpool Park LLP are both long term commitments with no specified end date. The business cases and model supporting the council's investment in Oportunitas and Otterpool are based on a 45 year and 30 year period respectively. The Council's future capital investment plans do not require the repayment of the equity investments. The Council has overall control of the both companies and can decide if it wants to review the level of its equity investment. For any future share or equity investment in other subsidiary companies or joint ventures it is likely these will also be a long term commitment, however this will be determined at the time the investment is being considered for approval.

4.8 **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the authority's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

5. **COMMERCIAL INVESTMENTS: PROPERTY**

5.1 **Contribution:** The Council invests in local commercial and residential land and property with the intention of making a capital gain or generating a new revenue stream that will be spent on local public services. The Council currently holds investment property for the following main reasons;

- i) Land and property to support the proposed Otterpool Park Garden Town development of up to 10,000 new homes over an approximate 30 year period. This excludes Westenhanger Castle, which while part of the

Otterpool Park Garden Town development, is planned to be used for its community benefit rather than a direct financial return.

- ii) Land for other commercial and residential development, including the Biggins Wood site in Folkestone.
- iii) Commercial and light industrial units for local businesses providing employment opportunities and the authority with a net rental stream.
- iv) The Connect 38 office accommodation in Ashford to provide the authority with an additional net revenue stream.
- v) The Folca building, Folkestone (former Debenhams) whose future use will form part of the Place Plan for Folkestone town centre.

5.2 The table below summarises the value of the Council's investment assets grouped by property type measured against the original purchase or construction cost. For some assets the original purchase or construction cost data is not available in which case the value of the asset at 1st April 2014 has been used as a proxy value with changes since then shown as a gain or loss.

Table 4 - Property held for investment purposes

Property Type	31/03/2020 (Actual)			31/03/2021 (Projection)		
	Actual Purchase Cost	Accrued Gains (Losses)	Value in Accounts	Actual Purchase Cost	Accrued Gains (Losses)	Value in Accounts
	£m	£m	£m	£m	£m	£m
Commercial and Light Industrial (existing)	1.102*	0.485	1.587	1.102*	0.485	1.587
Other Land	1.214*	(0.407)	0.807	1.214*	(0.407)	0.807
Otterpool land and property (acquired to 31/03/20)	34.681	21.249	55.930	34.681	21.249	55.930
Otterpool land and property (acquired 2020/21)	n/a	n/a	n/a	3.145	-	3.145
Connect 38 Offices	17.711	(0.711)	17.000	17.711	(0.711)	17.000
Retail – Folca Building (acquired 20/21)	n/a	n/a	n/a	2.340	-	2.340
Total	54.708	20.616	75.324	60.193	20.616	80.809

* Includes assets where a proxy value has been used based on their value at 1st April 2014

- 5.3 All land and property classified as Investment Assets is required to be measured at its market value as at 31 March each year for inclusion in the authority's Statement of Accounts. At the time of writing, no information was available regarding potential changes in the market value of these assets as at 31 March 2021 meaning, where appropriate, they are shown at either their value as at 31 March 2020 or purchase cost if acquired in 2020/21 in table 4, above.
- 5.4 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. However, it is recognised the Council is acquiring land for development reasons and therefore its existing use value as an investment asset may be significantly lower than its future potential value.
- 5.5 A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2020/21 year end accounts preparation and audit process value these properties below their purchase cost and there is no reasonable prospect of this being reversed as a result of the Council's investment plans, then an updated investment strategy will be presented to full Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.
- 5.6 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by preparing a business case to support the proposed investment. This includes:
- 5.6.1 Assessing the current and expected future market demand and need for relevant property by reference to local, regional or national data, including rental and occupancy levels.
- 5.6.2 Assessing the current and expected future market competition for the type of property being considered.
- 5.6.3 Identifying the relevant legal power the authority is using to undertake the purchase and whether or not it may need to purchase and operate it through a separate entity such as a company or joint venture.
- 5.6.4 Identifying how the authority can recover or dispose of its interest in the property without financial loss.
- 5.6.5 Undertaking a whole-life financial assessment for the proposed scheme to identify any on-going investment that may be required.
- 5.6.6 Using specialist external advisors such as, valuers, surveyors, property agents, solicitors and taxation and other finance specialists to help evaluate the proposed investment if required.
- 5.6.7 Using the Council's established procurement and contract management procedures to appoint and monitor the performance of external advisors it uses. This can involve;-

- interviewing potential consultants to gain a better understanding of their breadth of experience and knowledge in the specific area,
- liaising with other local authorities through established groups and channels to discuss the suitability of consultants being considered where it is known they have been used before,
- focusing advice on larger firms with the breadth and depth of expertise to minimise risk, and
- utilising our own professional judgement to consider the advice received.

5.6.8 Using credit checks if required to assess the financial strength of third parties the Council could be exposed to, for instance where the authority proposes to purchase an investment property which has existing commercial tenants. Credit ratings are not applicable as part of the assessment process for property investment.

5.6.9 The Council has established a proactive risk management culture within the organisation, including all key projects being required to consider risks, as well as quarterly monitoring and reporting of key corporate risks which includes, at times, key investment plans such as the delivery of Otterpool.

5.7 **Liquidity:** 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.

5.8 The Council's commercial and light industrial units' portfolio is viewed as a long term commitment providing valuable local jobs and supporting the local economy. Any decision to dispose of existing units would need to be balanced against providing alternative employment opportunities, continuing to support the local economy as well as the direct financial impact to the authority.

5.9 Where property is held for future development reasons the Council will identify how it intends to recover or access the cost of its capital investment as part of any proposal for the specific development.

6. PROPORTIONALITY

6.1 The current Medium Term Financial Strategy (MTFS) does include property and service investment income as part of its projections from schemes and initiatives already in place or agreed. The MTFS currently excludes the benefit from any potential capital gains or new revenue streams from the proposed Otterpool Park development. However, the MTFS is over the medium term in a deficit position of about £13.6m and the authority is continuing to explore investments to support the closure of this gap (along with an internal Transformation programme). As the Council's wider investment plans continue to develop further consideration will be given to its approach to proportionality in respect of investment income to gross service expenditure. Table 5 below shows the extent to which the service delivery objects of the Authority is dependent on achieving the expected net return from its investments over the life of the MTFS.

Table 5 - Proportionality of Investments

	2019/20 Actual	2020/21 Forecast	2021/22 Budget	2022/23 Projection	2023/24 Projection
Gross service expenditure	118,642,076	105,350,100	101,485,500	103,515,200	105,585,500
Net investment income to General Fund	(2,375,114)	(1,775,800)	(1,588,800)	(1,663,400)	(1,681,100)
Proportion	2.00%	1.69%	1.56%	1.61%	1.59%

7. CAPACITY, SKILLS AND CULTURE

7.1 Elected members and statutory officers:

7.1.1 All members are provided with a full training session on treasury management and investments by the authority's Treasury Management advisors (Arlingclose Ltd). This is conducted regularly with the next session due later in 2021 and encompasses all members and not just those on the relevant committees. Training is also held on specific issues for nominated councillors (such as on Investment Appraisals) and there are ongoing briefings for individual members with specific responsibilities such as the Finance Portfolio holder, the Chair of the Audit and Governance Committee and the Group Leaders of the political parties represented on the Council. All members have a wide exposure to investment decisions and are able to interrogate officers either formally or informally.

7.2 Commercial deals:

7.2.1 The Council has a process in place whereby all proposed capital investment decisions are referred to Financial Services and Legal Services to ensure compliance with the principles of the prudential framework and of the regulatory framework for local authorities. For individual major projects, including commercial property investments, a project board or working group is established at the outset which includes officers from Financial Services and Legal Services who advise on compliance with statutory guidance and regulatory issues.

7.3 Corporate governance:

7.3.1 The Council has a clearly articulated corporate plan and associated values which are being refreshed as part its transformation programme. It also has a long standing practice of regular and transparent decisions in relation to investments held for both treasury management purposes and also for investment purposes. The governance structure includes scrutiny of all decisions through the Overview and Scrutiny Committee prior to these being considered by Cabinet. Any new investment decisions need to be approved by Full Council with a full explanation of the benefits, opportunities and risks

associated with any proposal. The ongoing performance of investments is regularly reported back to Members and is subject to ongoing review and monitoring.

8. INVESTMENT INDICATORS

- 8.1 The Council proposes to set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.
- 8.2 **Total risk exposure:** The first 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 it has issued over third party loans.

Table 6 - Total investment exposure in £millions

Total investment exposure £m	31.03.2020 Actual	31.03.2021 Forecast	31.03.2022 Forecast
Treasury management investments	29.7	20.0	20.0
Service investments: Loans	8.2	7.5	27.3
Service investments: Shares	1.3	4.6	10.7
Commercial investments: Property	75.9	81.4	95.2
TOTAL INVESTMENTS	115.1	113.5	153.2
Commitments to lend	2.5	2.5	39.2
TOTAL EXPOSURE	117.6	116.0	192.4

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

Table 7 - Investments funded by external borrowing in £millions

Investments funded by borrowing £m	31.03.2020 Actual	31.03.2021 Forecast	31.03.2022 Forecast
Service investments: Loans	-	0.4	1.7
Service investments: Shares	1.0	3.3	9.6
Commercial investments: Property	44.4	46.1	63.3
TOTAL FUNDED BY EXTERNAL BORROWING	45.4	49.8	74.6

- 8.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. This indicator includes the impact of (unrealised) valuations gains and losses. 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.

Table 8 - Investment rate of return (net of all costs)

Investments net rate of return	2019/20 Actual	2020/21 Forecast	2021/22 Forecast
Treasury management investments	2.4%	1.7%	2.0%
Service investments: Loans	2.2%	2.6%	2.8%
Service investments: Shares	(27.3%)*	0.0%	(1.0%)
Commercial investments:			
Otterpool Land and Property	(3.2%)*	(0.5%)	(0.1%)
Connect 38 Offices	2.8%*	1.6%	1.3%
Other Commercial & Light Industrial Property	(12.6%)*	5.5%	5.3%
ALL INVESTMENTS	0.3%	0.5%	0.8%

* Net returns include unrealised valuation losses or adjustments which do not impact on the net cost to the General Fund.

- 8.4.1 The net return on loans made for service investments includes those that are interest free and are accounted for as 'soft loans', including private sector housing improvement loans.

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