

SURREY COUNTY COUNCIL**CABINET****DATE: 23 JULY 2013****REPORT OF MS DENISE LE GAL, CABINET MEMBER FOR BUSINESS SERVICES****MR TONY SAMUELS, CABINET MEMBER FOR ASSETS AND REGENERATION PROGRAMMES****LEAD OFFICER: JULIE FISHER STRATEGIC DIRECTOR FOR BUSINESS SERVICES****SUBJECT: INVESTMENT STRATEGY****SUMMARY OF ISSUE:**

Following the Medium Term Financial Plan (MTFP(2013-18) Budget report in February 2013, Full County Council agreed the need;

- to take steps to ensure that the Council maintains its financial resilience and protects its long term financial position
- to explore and develop alternative sources of funding that reduce its reliance on Government grants and council tax increases in the future
- for provision in the MTFP (2013-18) to meet the costs of initiatives that will deliver savings and enhance income in the longer term.

Cabinet also reaffirmed in March 2013 the importance of innovation in the delivery of services in the interests of Surrey residents and businesses and agreed to develop the Council's approach to trading as one example of how the Council would take opportunities to improve services and value for residents.

Following further work to examine the scope for such initiatives, this paper sets out:

- the Investment Strategy to enhance income to the council in the longer term.
- the proposed governance framework, including establishment of an Investment Advisory Board to advise Cabinet on implementation of the investment strategy.
- the proposal to establish, subject to a full business case, a Property Investment Company.

RECOMMENDATIONS:

It is recommended that:

1. Cabinet approve the Investment Strategy including the proposed process that will determine which investment opportunities come forward for decision by Cabinet
2. Cabinet approve the governance arrangements and establishes an Investment Advisory Board comprising 4 Cabinet Members supported by appropriate officers (including the Monitoring Officer and the Chief Finance

Officer) who will consider individual investment opportunities and provide advice to Cabinet on investment decisions.

3. Cabinet approve the commencement of the procurement process for the appointment of an Investment Advisor or Advisors to provide advice to the Council, with contract award being approved in line with the standard process.
4. Cabinet approves the development by the Strategic Director for Business Services of a full business case for the establishment of a Property Investment Company to be wholly owned by the County Council, for consideration at a future Cabinet meeting.

REASON FOR RECOMMENDATIONS:

The proposed Investment Strategy set out in this paper will provide a framework for investing in innovative solutions and opportunities that enable the council to maintain its financial resilience and increase income whilst providing effective services.

Decisions made to implement the strategy will be in accordance with the governance arrangements described.

DETAILS

INVESTMENT STRATEGY

1. The Council's MTFP (2013-18) sets out the challenges facing the council in terms of financial resilience and its long term financial position. In addition to considering the scope for improving the efficiency of service delivery and for making substantial savings in existing budgets, the Council is examining new approaches to generate additional income that can be used to support its functions and the delivery of services. The Budget report to Council in February 2013 identified the need to enhance income and in March the Cabinet also approved arrangements for the development of trading vehicles. The paper considered in March identified that trading would improve the delivery of services but could also generate income for the council to help deliver longer term financial resilience.
2. The development of a portfolio of investments - covering investment in property and assets and in new models for service delivery – supports the Council's stated intentions of enhancing financial resilience in the longer term and will be delivered through:
 - the adoption of an Investment Strategy; and
 - the establishment of appropriate governance arrangements, including the creation of an Investment Advisory Board within the Council to provide advice to Cabinet on the implementation of the Investment Strategy.

In addition these arrangements would also allow for investment in schemes that will support economic growth in Surrey provided that these schemes are consistent with the Investment Strategy outlined in this report.

3. The proposed strategic approach to investment is based upon the following;

- prioritising use of the Council's cash reserves and balances to support income generating investment through a Revolving Investment and Infrastructure Fund (the Investment Fund) to meet the initial revenue costs of funding initiatives that will deliver savings and enhance income in the longer term (some of which may be used to replenish the Investment Fund)
- using the Investment Fund to support investments in order to generate additional income for the council that can be used to provide additional financial support for the delivery of functions and services
- investing in a diversified and balanced portfolio to manage risk and secure an annual overall rate of return to the Council
- investing in schemes that have the potential to support economic growth in the county
- retaining assets where appropriate and undertaking effective property and asset management, and if necessary associated investment, to enhance income generation.

Governance

4. Decisions on taking forward each investment opportunities will be taken by Cabinet. However, the development of the Investment Strategy is likely to mean more decisions coming forward for consideration and an Investment Advisory Board will be established to provide advice to Cabinet. This will ensure appropriate rigour in advance of Cabinet decision: by ensuring only credible options are progressed to Cabinet, and providing the forum for strategically managing the overall portfolio of investments consistent with the aims of the Investment Strategy, The Investment Advisory Board which will comprise 4 members of Cabinet:

- Leader of the Council
- Deputy Leader
- Cabinet member for Business Services
- Cabinet member for Assets and Regeneration Programmes

Officer support will be provided by:

- Chief Executive
- Strategic Director for Business Services
- Chief Property Officer
- Monitoring Officer (Head of Legal Services)
- Chief Finance Officer.

5. The Investment Advisory Board would consider all proposals that contribute to the delivery of the investment strategy and meet the investment criteria. In some cases these could be investments which form part of wider proposals which have a primary focus on improving services but which may, for example, involve property or assets or trading as part of the delivery mechanisms.

11. Gateway One comprises a number of criteria to determine whether there is an opportunity to consider and take forward. Gateway One establishes whether the opportunity can be recommended to Cabinet for in-principle agreement or full agreement, or that the opportunity does not meet the decision criteria and therefore proceeds no further. Gateway Two involves the development of a much more detailed business case to be considered by the Investment Advisory Board, and for approval by Cabinet as appropriate.

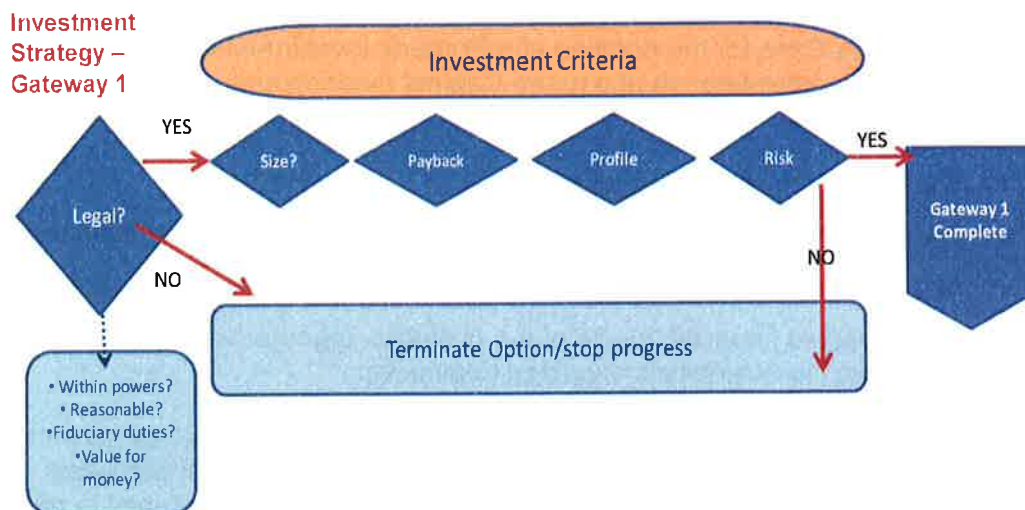
Gateway One

12. Gateway One will address the criteria listed below. Some of the criteria relate to the characteristics of the specific opportunity; others are concerned with the effect of that opportunity on the overall portfolio. The strategy envisages that the balance between different types of investment as in (d) below will be achieved over a period of 3 to 5 years. An opportunity needs to meet each of the criteria:

- (a) The acquisition or investment is within the powers of the Council and can be undertaken with appropriate regard to tests of reasonableness, fiduciary duty and value for money.

If this is the case, then the following criteria will be evaluated:

- (b) The amount of investment required is greater than the threshold for investment which has been set for the Investment Strategy (initially more than £10 million except for Trading opportunities where this threshold will not apply)
- (c) The period over which a return will be made is consistent with the overall balance that the Investment Strategy has set for a medium and longer term return (less or more than 5 years respectively).
- (d) The opportunity will fit within the ceilings which have been set for the Investment Strategy in terms of the balance between property investment and other forms of investment.
- (e) The return on the investment is consistent with the rate of return that has been set for the level of risk involved (within tolerances) which will be considered as part of the development of the full business case.



criteria described above. Under such circumstances, borrowing costs would be met by the Company. Loans would be made available to the Company on a basis which is compliant with the Market Economy Investor Principle so that the terms of funding are similar to those which would be achievable by a private funder given the structure and risks associated with the portfolio. This is important both in the context of Competition law and State Aid rules and further specialist advice will be sought as the part of the development of the business case.

19. For property investments the detailed Gateway Two process would require specific criteria for a property Investment Strategy to be established to be applied by the Company. Within each criteria 'ceilings' (i.e. upper limits) are proposed in order to ensure a balanced portfolio is established and the agreed risk profile maintained:
- (a) The opportunity will fit within the ceilings that have been set for the balance between investment in existing property and assets and in higher risk development schemes (80% and 20% respectively of the overall value of the investments within the property portfolio). Development related investment opportunities have higher risks but also provide a greater rate of return. If situated within Surrey, wider benefits can be achieved such as additional housing development, new business premises or town centre developments which will generate additional economic growth. Where there is a choice of investment opportunities with a comparable financial return, the Company will give priority to securing such additional benefits for Surrey.
 - (b) The opportunity will fit within the ceilings which have been set for the Property Investment Strategy in terms of the balance between retail, industrial, office and other property. These have been set at 52.5%, 22.5%, 12.5% and 12.5% respectively of the overall value of the investments, once fully invested, with a tolerance of +/- 5%. This mix will be reviewed on a minimum of an annual basis by the Investment Advisory Board.
 - (c) The opportunity will fit within the ceilings that have been set for the balance between investments in London and the South East and the rest of the UK.
 - (d) The return on the investment is consistent with the rate of return that has been set for the level of risk involved.
20. Once investments have been made, ensuring that target rate of return is achieved for the property investment portfolio will require specialist advice on:
- (a) investment management to optimise value with annual Business Plans for each investment which examine the scope to add value, the risks involved and the time scale for delivering the investment opportunity and which, taken together, allow for portfolio management. Performance analysis will take place on an annual basis including benchmarking against similar funds and will be supported by independent valuations.
 - (b) asset and property management to maintain and improve the financial performance of an investment property including ensuring statutory and

tenant and a cap on the single asset value as a percentage of Gross Asset Value.

- Professional advice on asset management will be sought as part of the appointment of investment advisors given the significance of asset management to the generation of returns.

Financial and Value for Money Implications

26. The objective of the Investment Strategy is to use the council's resources to invest in income generating assets and trading opportunity proposals to partially offset the impact of the reduction in government grants over the longer term and to protect service provision while minimising the burden on the local council tax payer.
27. The Council may fund investments through using its reserves, capital receipts and prudential borrowing, where the council has the powers to do so. Any borrowing required would need to be made in accordance with the conditions of the Prudential Code, which includes the council approving any changes required to the prudential indicators. The code requires borrowing to be affordable, sustainable and provide value for money. The return on any investment would therefore need to be in excess of the capital financing costs of the borrowing, which consist of the interest payable and the statutory minimum revenue provision (MRP) that sets aside funds for the repayment of the borrowing.
28. The Investment Strategy is being brought forward under the extended powers created by the Localism Act 2011. The Monitoring Officer's report below outlines the council's ability to proceed under these powers and highlights legal advice received which urges a degree of caution. Furthermore, it is the opinion of the external legal advice obtained, that borrowing to invest for return is still considered unlawful for local authorities and that the intention of the Localism Act is not to change this restriction. The underlying principals of investment by local government are governed by the priority of security, liquidity and yield-in that order of priority. The DCLG acknowledges that the Localism Act could potentially increase the risks taken by local authorities, but states that in their opinion there is a complex system of checks and balances in place to prevent inappropriate risk taking that would lead to concerns about the use of public funds. These checks include the Prudential Code and the requirement to exercise sound fiduciary duty.
29. All investments will require a robust business case to ensure that the investment is affordable, sustainable and provides value for money. Some investments will generate a return in the medium to long term but make a loss in the earlier years. The council has provided a Revolving Investment & Infrastructure Fund of £20m that will be used to fund the initial capital financing costs in the short-term until investments generate a net return. Returns made on investments will repay this fund, which in turn will enable further future investments to be made.
30. Assets created through these investments, and the associated liabilities, including those that are made by the proposed Property Investment Company, will be consolidated in the Council's balance sheet and treated in accordance with the Code of Practice on Local Authority Accounting in the

- Secondly, if the exercise of a “pre-commencement power” is “subject to restrictions, those restrictions apply also to exercise of the general power so far as it is overlapped by the pre-commencement power”. A “pre-commencement power” means, among other things, a power conferred by an existing Act or statutory instrument.
 - Lastly, a Council may “do things for a commercial purpose only if they are things which the authority may, in exercise of the general power, do otherwise than for a commercial purpose”.
36. Cabinet will also wish to note that any things done for a commercial purpose must be done “through a company”, principally being a company within the meaning of s.1(1) Companies Act 2006. Usually where a separate legal entity is established, there will be corporation/income tax and VAT considerations, which do not apply to the Council’s core activities. Tax implications would need to be considered in the context of the business case, probably with specialist advice from external advisors.
37. Each individual investment proposal would need to be thoroughly examined before proceeding. However, testing the principle of the proposed investment scheme against the general power, an individual has power to buy, let, develop, and manage property for investment purposes and commercial gain and to set up or purchase a company for these purposes. The Council also has power to buy and manage property for non commercial purposes and so should be able to use the general power, to buy and manage property for commercial purposes.
38. Nevertheless, the advice received to date urges a degree of caution: To quote from the QC consulted by the Head of Legal and Democratic Services
- “The Council’s proposed schemes are, undoubtedly, novel” “I am not aware of any [local Authorities] that are proposing schemes similar to these. Although the general power of competence under s.1 LA 2011 is widely drawn, there is almost no Guidance on its use and no case authority on its meaning. The Council needs to be fully aware of these uncertainties in deciding whether, and how, to proceed”*
39. General principles of decision making apply continue to apply to schemes enabled by the Localism Act, and so must be made in good faith, taking into account all relevant considerations, ignoring irrelevant matters, not irrational, balancing the risks against the potential rewards alongside the other relevant duties. In considering a new form of investment strategy Cabinet particularly needs to bear in mind its fiduciary duty to Surrey taxpayers and has to demonstrate that its decisions are those which a prudent and reasonable local authority would enter into, adopting an evidenced-based approach and prudent use of the Council’s financial and other resources. The preparation of a thoroughly researched business case is key to that properly evidenced decision process.

Equalities and Diversity

40. There are no direct equalities and diversity implications in creating and managing the Investment Strategy although the Investment Advisory Board will take into account ethical issues when making recommendations to acquire investment opportunities.