

Investment Strategy

Introduction

- 1 The Authority invests its money for three broad purposes:
 - a) 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),
 - b) to support local public services by lending to or buying shares in other organisations (service investments), and
 - c) to earn investment income (known as commercial investments where this is the main purpose).
- 2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories. The LLAL stabilisation and recovery plan has been factored as part of the strategy and the has also been covered as part of the agenda item EX/02A/21/14

Treasury Management Investments

- 3 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 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 Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £50m and £10m during the 2021/22 financial year.
- 4 The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.
- 5 Full details of the Authority's policies and its plan for 2021/22 for treasury management investments are covered in a separate document, the treasury management strategy, available here: [Treasury Management Strategy 2020-21](#)

Service Investments: Loans & Shares

- 6 The Council invests in its subsidiaries, London Luton Airport Ltd (LLAL) and Foxhall Homes Ltd, to support local public services and stimulate local economic growth. The Council invests using equity shares and debenture loans. Dividends payable are assessed annually with the ultimate objective of releasing profits to support statutory services. All loans approved to date are maturity loans with interest charges paid annually.
- 7 Loans to be approved for issue to LLAL are to support the stabilisation plan and to support the completion of major capital schemes. These will take the form of debentures and redeemable preference shares.
- 8 In addition to these schemes there are a number of historical loans held by LLAL.

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- 9 Loans have been approved to support a number of housing projects being developed by Foxhall Homes Ltd. The development loan and share capital is forecast to be £32.7m by March 2021, with a further £13.1m built into the capital programme for 2021/22
- 10 The Council has partly owned companies, QED Luton (Challney) Group Ltd and Luton Learning And Community Partnership Limited (LLCP). The companies are co-owned with Building Schools for the Future Investments (BSFI) LLP and were created to develop and manage a private finance initiative for the Luton Schools project initiated in 2009. The main objective of the company is the development and ongoing maintenance of the Challney Boys School buildings. The Council has a shareholder interest.
- 11 The Council is currently a shareholder in three companies. There are no current plans for an investment in any future ventures. The level of shares issued to Foxhall Homes is expected to increase over the short term to finance existing and future developments.
- 12 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:

Organisation	Estimated Debt 31/03/2021 £m	Debt Exposure Limit £m	Estimated Share Capital 31/03/2021 £m	Share Capital Exposure Limit £m
London Luton Airport Ltd	357.8	357.8	45.5	45.5
Foxhall Homes Ltd	13.7	33.8	2.9	10.8
LLCP/BSFI Companies	0	0.	0.5	0.5

The exposure limits represent the currently approved amount by Full Council

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- 13 The council assesses the risk of loss before entering into and whilst holding service loans by assessing the financial position, performance and other external influencing factors, including the current market conditions. None of the companies currently hold a credit rating and there is no intention for this to change. This makes the assessments described above necessary to satisfy financial due diligence before financial commitments are approved.
- 14 The financial position will be assessed by a review of the company's Balance Sheet and the use of ratios to monitor the financial strength, management and risk of the council's investment. The ratios can be used to compare the financial position to market benchmarks, historical positions and previously forecasted positions.
- 15 The financial performance of the company will be assessed by examining the company's profitability and business plan. This will include ratios examining the entities ability to repay interest and principal, and an assessment of current and future profitability.
- 16 A number of other factors will be assessed which will cover more subjective reviews. The use of external advisors will be important in ensuring the market conditions and future competition is understood and risks evaluated.
- 17 Each separate decision to invest is supported by a robust Business Case. In most cases the use of external advisors is necessary to create a robust and coherent case for future investment. In more complex and complicated investment decisions and the LLAL stabilisation plan, additional governance is introduced into the decision making process. All major investments will undergo scrutiny of the business case before commencement. This will normally take the form of a separate Task & Finish Group comprising of cross party members.
- 18 The Council will assess the term of any additional debt or share capital financing on a decision-by-decision basis. The liquidity and profitability assessment will be made to maximise the delivery of the Council's statutory operations and to manage the level of risk the Council is exposed to.
- 19 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 Council's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none is likely to meet the definition.

Commercial Property Investments

- 20 The Council invests in local, regional and UK property with the intention of making a profit that will be spent on local public services. The below table summarises the investment portfolio currently held.

Property Group	Original Price (£m)	Current Value 31/03/2020 (£m)	Net Gain / (Loss) (£m)
Retail & Retail Parades	38.1	33.5	-4.6
Leisure	2.5	3.3	0.8

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Offices	38.8	43.3	4.5
Industrial	10.6	12.0	1.4
Other	6.3	4.1	-2.2
Total	96.3	96.2	-0.1

- 21 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. The above table illustrates a net gain in valuations across the portfolio. Properties held before 2013 are included at the value as at this date or the first year the property was valued as an investment property.
- 22 The Council follows the government guidance in respect of Minimum Revenue Provision (MRP) and therefore sets a side an annual repayment based on the estimated useful life of the asset. Since 2013, the Council will have made MRP of £2.0m by March 2021 towards commercial property purchases. Further MRP has been allowed for as part of the revenue budget to cover the debt servicing and capital repayment costs associated with any potential support form MLCLG.
- 23 The net movement in property valuations will be assessed annually to ensure security risk is managed effectively.
- 24 Further details on the Commercial Property investment policy is included within the Capital Strategy.
- 25 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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council will continue to assess the portfolio and only dispose of a property when it does not meet the requirements of the strategy in terms of financial returns or level of risk.

Proportionality

- 26 The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place-making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Council's contingency plans for continuing to provide these services in the short term as a last resort is to use earmarked reserves to balance the budget. This is only sustainable in the short term and service reduction and efficiencies would be required to maintain a sustainable budget in the longer term.

	2019/20 Actual	2020/21 Budget	2021/22 Budget	2022/23 Budget	2023/24 Budget
Net Revenue Stream	137.5	147.6	149.4	151.9	154.1
Net Commercial income	38.2	24.2	32.1	36.5	37.6
Proportion	27.8%	16.4%	21.5%	24.0%	24.2%

Borrowing in Advance of Need

- 27 Government guidance is 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.
- 28 Where a local authority chooses to disregard the Prudential Code and this Guidance, and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain why. While the Council's Corporate Asset Plan and objectives set out in this Strategy are to generate income, all investments made contribute to meeting Corporate and Capital Asset goal of economic growth and creating wealth in Luton.
- 29 The Council has no plans to borrow in advance of need or to invest only to generate a yield and is therefore compliant with the requirements of the Prudential Code in respect of this matter and the guidance issued by HMT.

Capacity, Skills and Culture

- 30 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Where skills, or capacity are lacking, the Council will buy in suitably qualified professionals to assist Council Officers and Members to ensure informed decisions are made when entering into a specific investment. The Council measures the impact of investment decisions on borrowing and affordability through the Prudential, Treasury and Investment Indicators, and Medium Term Financial Strategy, to ensure overall risk exposure remains within acceptable levels.
- 31 The Council's Property & Construction team together with senior Finance Officers work closely when negotiating commercial transactions. The Corporate Leadership Management Team (CLMT) provides the setting for challenge of new investment proposals ensuring the core principles of the prudential framework and the regulatory regime within which the Council operate are adhered to.
- 32 The Service Management Teams will submit capital bids, to the Service Director (Finance, Revenues and Benefits) and then subsequently CLMT, to support service and commercial capital investment proposals that contribute to meeting the Council's objectives set out in the Corporate Plan. Full Council is required to approve investment in new capital schemes prior to any expenditure being incurred.

Investment Indicators

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- 33 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

A. Total risk exposure

- 34 The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down.

Total Investment Exposure	31 March 2020 Actual (£m)	31 March 2021 Forecast (£m)	Total Approved (£m)
LLAL Equity & Debt	281.7	403.3	403.3
Foxhall Homes Equity & Debt	2.7	16.6	16.6
LLCP/BSFI Companies Equity & Debt	0.5	0.5	0.5
Commercial Property	96.2	115.5	115.5
Total Investments	381.1	535.9	535.9
Treasury Management Strategy Non-Specified Investments limit			£600.0m

- 35 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 majority of investments could be described as being funded by borrowing, whether it be internal or external borrowing. As MRP and/or capital receipts relating to these investments are received the underlying need to borrow reduces.

B. Rate of Return

- 36 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. 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.

Investments net rate of return	31 March 2020 Actual	31 March 2021 Forecast	31 March 2022 Forecast
LLAL Equity & Debt	£30.5m (15.3%)	£16.4m (5.2%)	£24.1m (6.1%)

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Foxhall Homes Equity & Debt	£1.0m (5.7%)	£1.6m (5.7%)	£1.6m (5.7%)
LEP & BSF Entities Equity & Debt	£0.1m (4.8%)	£0.1m (4.8%)	£0.1m (4.8%)
Commercial Property	£6.7m (6.2%)	£6.6m (6.0%)	£7.0m (6.4%)

- 37 The LLAL return percentage falls noticeably due to the increase in proportion of debt financing in comparison to equity financing. The debt financing returns 8%, which includes a risk premium for the Council, but this is substantially less than the historic equity return which was above 40%. Under the current stabilisation plan, new loans will be advanced at a lower interest rate of 4% and no dividend has been assumed during the MTFP horizon.

C. Commercial income cover ratio

- 38 This ratio compares the council's investment returns to the interest cost of borrowing to fund the investments. This illustrates the risk and reliance on income generated to meet the committed debt financing costs.

Commercial income cover ratio	31 March 2020 Actual £m	31 March 2021 Forecast £m	31 March 2022 Forecast £m
Commercial Income	45.5	35.7	42.2
Interest Payable (General Fund)	5.2	9.1	7.5
Cover Ratio	8.8	3.9	5.6

- 39 The cover ratio is again reducing annually due to the lower margin in the debt financing in comparison to the current position. The current position is significantly influenced by the loss of the LLAL dividend.

D. Loan to value ratio

- 40 This ratio identifies the proportion of the council's long-term assets which are funded through external debt.

The loan to value ratio	31 March 2020 Actual £m	31 March 2021 Forecast £m	31 March 2022 Forecast £m
Total Long Term Assets	1,432.0	1,641.5	1,772.5

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External Borrowing	500.3	669.7	743.7
Loan to Value Ratio	34.94%	40.80%	41.96%

- 41 The use of debt financing to fund the commercial activities of the Council is making a substantial impact on the value of assets funded by debt. The recent CIPFA Resilience assessment identified the current level of borrowing as being in the low risk category, but as the level of borrowing increases the Council is likely to be classified as high risk.

E. Ratio of investment property to total investments

- 42 This ratio identifies the council's reliance to the property market in comparison to other sectors. This will illustrate whether the council spreads risk across sectors.

Investment property %	31 March 2020 Actual £m	31 March 2021 Forecast £m	31 March 2022 Forecast £m
Total Investments	381.1	405.3	530.6
Commercial Property Portfolio	96.2	115.5	115.5
Commercial Property %	25.24%	28.50%	21.77%

- 43 The current percentage of investments in commercial property remains high, its decline from 40.7% in the previous year is due only to the significant increase in overall expenditure in investment property, primarily LLAL. This does not represent the full exposure to the property market as the Foxhall Homes investments are in the residential property market and LLAL have a number of commercial development projects in progress.