



Overview and Budget Scrutiny Committee

16 November 2017

Investment Strategy: Investment Board Annual Report

Purpose of the report: Scrutiny of the Investment Strategy

To provide an update to Members on the Investment Strategy and an opportunity to review the Annual Report of the Investment Board.

Introduction: Investment Strategy

1. The Investment Strategy agreed by Cabinet in July 2013 was developed in response to the requirement for the Council to enhance its financial resilience in the longer term. The main principles of the Investment Strategy are as follows;
 - a. The creation of a diversified and balanced portfolio of investments to facilitate future service provision, manage risk and secure an ongoing annual overall return to the Council
 - b. Use of the established Revolving Investment and Infrastructure Fund (i.e. the Investment Fund) to meet the initial revenue costs of funding initiatives that deliver savings and enhance income in the longer term.
 - c. The Investment Fund is to be used to support investments that generate additional income to support the delivery of the Council's functions and services.
 - d. To undertake investments that have the potential to support economic growth in the county of Surrey, and,
 - e. Retaining assets where appropriate and undertaking effective property and asset management, and if necessary associated investment, to enhance income generation.
2. The investment portfolio of the Council is a combination of assets acquired or developed by the Council for future service needs, economic development and those acquired or developed by the property company. Cabinet approved the business case for the creation of the Property Company and associated subsidiaries in May 2014 in order to deliver the Investment Strategy and achieve a balanced property portfolio. The companies making up the Halsey Garton Property Group (HGP) were incorporated between June and July 2014.

3. The governance for the Investment Strategy is provided by the Investment Board (IB), established following the Cabinet report in March 2017. Previously this role was fulfilled by the Investment Advisory Board.
4. The Cabinet reviewed the strategy in March 2017, and in the context of the increasing financial challenges faced by the Council, considered whether it is appropriate to significantly increase the scale of investment in order to deliver more income in support of the Council's services. The Cabinet was supportive of further growth, to aim for net income of £10m per annum by 2020/21, noting that expanding the portfolio further will contribute to the creation of a diversified portfolio to mitigate against risk and that growth will be dependent upon appropriate opportunities coming to the market and upon market conditions more generally.
5. The assets required to deliver this scale of income will be determined by market conditions and the Council's risk appetite. As an indication, based upon the current market conditions, a net income return (after all costs including funding) of £10m per annum will require a portfolio of assets with a value between £500m and £1,000m.
6. The purpose of the Investment Strategy is to deliver an annual income stream in support of services and in doing so, the Council is not assuming any gain from the value of the underlying assets. Instead a long-term view is being taken since the value of the assets may decrease as well as increase over time.
7. Asset values for investment properties are determined by a number of factors, including market conditions, the length of lease left to run and the covenant of the tenant/s. Values are also sensitive to tax changes such as the changes to stamp duty in March 2016. Assets held by both the Council and HGP are revalued each year as part of the year-end statutory accounts process. Any unrealised gain or loss is shown in the Council's comprehensive income and expenditure statement, however this has no impact on the general fund of the Council – that is, no adverse implications for the tax-payer since adjustments of this nature are excluded according to statute. Similarly any revaluation gain or loss related to properties held by HGP is shown in the company's profit and loss statement as an unrealised gain or loss but has no impact on the profit that can be distributed to the Council as its shareholder. The Council can choose to sell assets only when it is appropriate and advantageous to do so since the rental income covers the associated funding costs.

Investment Board

8. The Investment Board (IB) is comprised of members of the Cabinet and the Chief Executive, supported by officers in Property, Finance and Legal. The IB is responsible for making investment decisions in accordance with the framework established by the agreed Investment Strategy and for the strategic management of the overall portfolio consistent with the aims of the Investment Strategy. A scoring matrix is used as a guide to this decision-making to help to ensure that opportunities are measured and assessed in a common manner. It is possible that opportunities will arise that do not score highly in the criteria but deliver a positive economic outcome and these will be progressed in accordance with the strategy to deliver schemes that support economic growth in the county. The matrix is attached as Annex 1 to this report.

9. The IB monitors the portfolio to ensure that an appropriately balanced and diversified portfolio is created over time, across the combination of directly Council-owned assets and those owned by HGP. Officers, supported by independent specialist professional advisors, support the IB. These specialist advisors periodically evaluate the recommended portfolio of property investment, taking into account market conditions and achievable returns.

Risks & Financial Implications

10. The objective of the Investment Strategy is to invest in income generating assets to partially offset the impact of reductions in government grants and to protect service provision. The Council may fund investments through the use of its reserves, capital receipts and prudential borrowing. All borrowing will be undertaken in accordance with the Prudential Code that requires the borrowing to be affordable, sustainable and value for money. All investments are required to demonstrate a return in excess of the opportunity cost of capital and other associated costs of delivery.
11. The Investment Strategy means that the Council is managing different financial risks. Investments will be subject to inherent economic and market risks which requires a balanced portfolio of investments to be built over time. The performance of the portfolio is monitored by the Investment Board. The strategy notes a preference toward assets within Surrey that are of good quality, in good or growth locations, however, in order to create a diversified portfolio a mix of geographical locations is required.
12. Development opportunities by their nature will have a higher risk profile but will also provide the opportunity for a greater rate of return. The strategy gives priority to development opportunities within Surrey where the wider benefits to the county will be taken into consideration, such as the provision of housing, new business premises or town centre regeneration.
13. The governance process put in place is designed to mitigate these risks. All investment expenditure is undertaken on the basis of a robust business case which takes into account due and proper consideration of the balance between risk and reward and an assessment of the underlying security of the investment to comply with the fiduciary duty the council holds. The Investment Board is responsible for monitoring the financial performance of the portfolio and monitoring the progress made in respect of achieving an appropriately balanced and diversified portfolio over the longer term

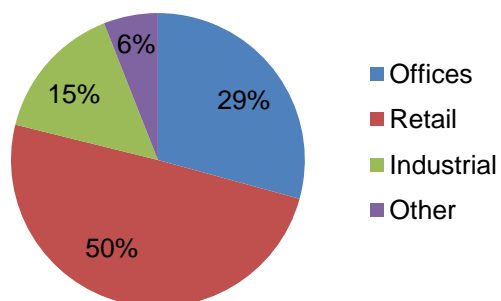
Investment Board Annual Report

14. The Annual report of the Investment Board is attached as Annex 2 to this report. A further report providing more detailed information is provided as a PART TWO confidential Annex 3. These reports were considered by Cabinet in July 2017 and were based upon the investment portfolio position as at 31 March 2017. A number of investment acquisitions have completed since March and therefore the key tables and highlights are updated below.

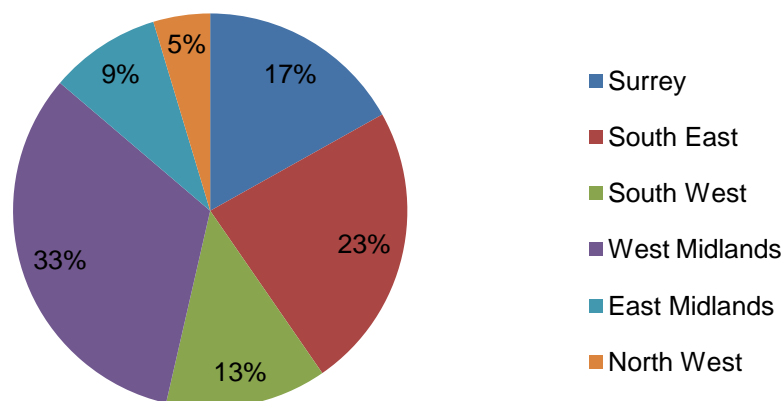
The total asset value of the property investment portfolio, based upon the valuation exercise undertaken at 31 March 2017 and incorporating assets under construction and subsequent assets at purchase value is £320m. This compares with £240m asset value as at 31 March 2017 as per the Annual Investment Report. The main change is the purchase of an out-of-town retail scheme in Malvern, Worcestershire and the land element of a forward purchase agreement for a pre-let warehouse development in Nottingham.



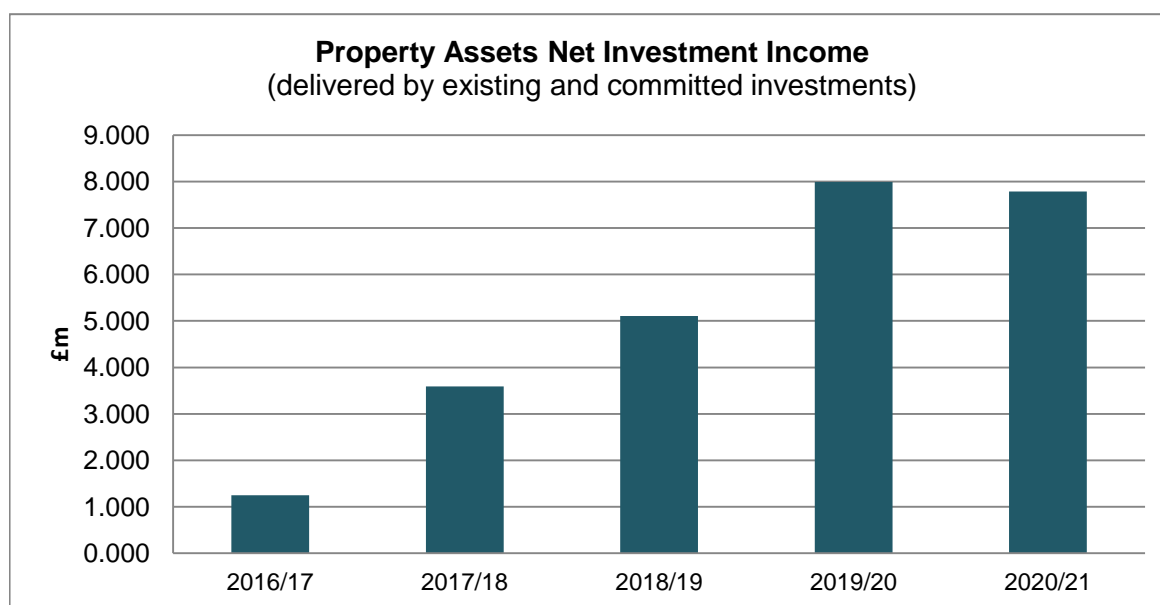
Current Portfolio as at 31.10.2017	Asset Value £m
Offices	94
Retail	159
Industrial	49
Other	19
Total	320



Asset Value by Location



Acquisitions made since March 2017 will deliver further income in addition to that reported in the Annual Report. The chart provided on page 8 of the Annual Report is updated below and shows the forecast net income returns from the current property investment portfolio and from committed schemes over a 5 year time horizon. Committed schemes include the second phase of development of the Crawley site, a forward purchase contract for a pre-let warehouse in Nottingham by HGP and the purchase of the commercial elements of the Brightwells scheme upon completion of the development.



Recommendation

That the Committee support the Council's approach to investment which is carried out in order to improve the Council's financial resilience over the longer-term and notes the role of the Investment Board and associated governance arrangements.

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Annexes:

- Annex 1: Investment Decision Guide
- Annex 2: Investment Board Annual Report (including Terms of Reference)
- Annex 3: Investment Board Annual Report **PART TWO** (Portfolio in detail)

Sources/background papers:

- Cabinet Report July 2013 – Investment Strategy
- Cabinet Report May 2014 – Establishment of a Property Company
- Cabinet Report March 2017 – Investment Strategy Review

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