

## **Appendix E5: Investment Strategy Report 2021/22**

### **Introduction**

The authority 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).

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.

### **Treasury Management Investments**

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 £100m and £70m during the 2021/22 financial year.

**Contribution:** The contribution that these investments make to the objectives of the authority is to support effective treasury management activities.

**Further details:** 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. (**Appendix E4**)

### **Service Investments: Loans**

**Contribution:** The council lends money to its subsidiaries, local businesses, local charities and its employees to support local public services and stimulate local economic growth. The council has lent £0.050m to its wholly owned subsidiary, Islington Limited (iCo), at market rate. The loan serves to support the working capital of iCo where the timings of its payments and receipts do not coincide. In addition, as at 31.03.2020, the council had lent £0.678m (including accrued interest) to three private companies responsible for managing schools under the Building Schools for

the Future programme (Transform Islington Phase 1 Holdings Limited, Transform Islington Phase 2 Holdings Limited and Transform Islington Limited). All loans were issued at market rates. Where loans are advanced at below market rates they are classed as 'soft loans'. As at 31.3.2020 the council had also issued around £1.1m of soft loans, mainly to employees (e.g. travel season ticket, gym membership, home computer loans).

**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 1: Loans for service purposes in £ millions*

Category of borrower	31.3.20 actual			2021/22
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries	0.050	(0.021)	0.029	0.100
Local businesses	0.678	0.000	0.678	0.750
Local charities	0.098	0.000	0.098	0.200
Employees	1.100	0.000	1.100	1.500
<b>TOTAL</b>	<b>1.926</b>	<b>(0.021)</b>	<b>1.905</b>	<b>2.550</b>

Accounting standards require the authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the authority's statement of accounts are shown net of this loss allowance. However, the authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

**Risk assessment:** The authority assesses the risk of loss before entering into and whilst holding service loans. In relation to iCo, the council has representation (2 councillors and 3 senior officers on the board and regularly monitors performance and financial risks. Regarding the soft loans available for employees, there is a process in place whereby employees can apply for the loans (season tickets, gym membership and a home computer scheme) and a monthly deduction is taken from salaries to repay this loan. There are procedures in place to deduct any remaining amount due in the event the employee leaves the organisation in their final pay cheque. In relation to the loan to a local charity, we provide grants to this organisation annually

in excess of the loaned amount. In the eventuality of a default, the organisation would reclaim payments through deductions grants or any other payments we make to them.

In relation to the three private companies responsible for managing schools under the Building Schools for the Future programme, the council has representation (a senior officer) on the board and regularly monitors performance and financial risks.

### **Service Investments: Shares**

**Contribution:** The council invests in the shares of its subsidiaries and local businesses to support local public services and stimulate local economic growth. The council holds equity investments in Islington Limited (iCo), a wholly owned subsidiary providing local services, and minority (10%) equity investments in three private companies responsible for managing schools under the Building Schools for the Future programme (Transform Islington Phase 1 Holdings Limited, Transform Islington Phase 2 Holdings Limited and Transform Islington Limited). The fair value of these shares is nil and the shares are not traded in an active market. The council has no current plans to dispose any of these shareholdings.

**Security:** One of the risks of investing in shares is that they can 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 2: Shares held for service purposes in £ millions*

Category of company	31.3.20 actual			2021/22
	Amounts invested	Gains or losses	Value in accounts	Approved Limit
Local businesses	N/A	0.096	0.096	0.150
<b>TOTAL</b>	<b>N/A</b>	<b>0.096</b>	<b>0.096</b>	<b>0.150</b>

**Risk assessment:** The authority assesses the risk of loss before entering into and whilst holding shares. The authority has no current plans to purchase any new shareholdings. In relation to the three private companies responsible for managing schools under the Building Schools for the Future programme, the council has representation (a senior officer) on the board and regularly monitors performance and financial risks.

**Liquidity:** Liquidity risk is considered low due to the nature of the shares held, their low value in the 2019/20 Statement of the Accounts (£96.4k for Transform Islington Limited and nil for all others) and the service reasons for holding the shares over the long term.

**Non-specified Investments:** Shares are the only investment type that the authority 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 authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

### **Commercial Investments: Property**

**Contribution:** The council invests in local and regional commercial property with the intention of making a profit that will be spent on local public services. The market value of all such properties as at 31.3.2020 was £33.2m. The council has not purchased new commercial properties in recent years nor does it have any plans to do so over the medium term. In 2019/20, rental income from investment property was £2.3m against direct operating expenditure arising from investment property of £2.3m

Additionally, although not strictly investment properties, the council's housing new build programme includes the building of private dwellings to sell on the open market. The upfront costs of building these private dwellings is funded by temporary borrowing for cash flow purposes, to be recouped by the capital receipts when the completed units are sold. These capital receipts also contribute to the funding of the wider new build programme of social housing. In 2021/22, there is forecast capital expenditure of £21.8m on the building of such private dwellings, of which £5.9m will be funded from temporary borrowing (on top. This temporary borrowing of £5.9m is currently forecast to be repaid in full by the end of 2025/26 from the estimated capital receipts.

The purchase cost of investment properties is not held as they do not have a revaluation reserve and all changes in value are credited/debited in the comprehensive income and expenditure statement.

*Table 3: Property held for investment purposes in £ millions*

<b>Property Type</b>	<b>Actual</b>	<b>31.12.20 Actual</b>	<b>31.3.21 expected**</b>
	<b>Purchase cost</b>	<b>Value in accounts</b>	<b>Value in accounts</b>
Admin Building	N/A	0.319	0.319
Advertising site	N/A	0.009	0.009
Café	N/A	0.340	0.340
Community Office	N/A	0.000	0.000
Offices	N/A	26.744	26.744

Shop	N/A	0.275	0.275
Store	N/A	2.985	2.985
Warehouse	N/A	2.508	2.508
<b>TOTAL</b>	N/A	<b>33.178</b>	<b>33.178</b>

\*We do not hold purchase cost information for investment properties as they do not have a revaluation reserve and all changes in value are credited/debited to the CIES.

\*\*2021/22 Valuations have not yet taken place.

**Security:** In accordance with government guidance, the authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the authority'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, 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.

**Risk assessment:** The authority assesses the risk of loss before entering into and whilst holding property investments. The council has no current plans to purchase new investment properties.

**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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the authority ensures dwellings are of a type and location that is marketable and has proven demand. The council also has scope to continue to generate an income stream whilst they are being marketed.

### **Loan Commitments and Financial Guarantee**

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the authority and are included here for completeness.

The council has provided a guarantee to its wholly owned subsidiary, Islington Limited (iCo), should it request it. There is currently no indication that this is likely to happen. The net current liabilities of iCo (Unaudited Statement of Accounts) as at 31.03.2020 were £0.017m.

## **Net Zero Carbon**

As a responsible investor, the council is committed to considering environmental, social, and governance issues, and has a particular interest in taking action to contribute to our strategy of Building a Net Zero Carbon Islington by 2030.

However, investment guidance, both statutory and from professional guidelines (CIPFA), dictates that investment activities must adopt 'SLY' principles – prioritising security, liquidity and yield.

There are already touch points with local authority investing, including the incorporation of Environment, Social and Governance (ESG) metrics into credit rating agency assessments. There are also a small, but growing number of financial institutions and fund managers promoting ESG products. Advisors are looking at ways in which to incorporate these factors into their creditworthiness assessment service that will be shared and adopted. The council will continue to monitor this as the market develops, noting that the lack of consistency and coverage in current market products alongside the treasury management 'SLY' priorities means that it is not currently practicable to formally include ESG targets as part of our treasury management or investment strategies.

It is the council's intention to exploit the treasury strategy to further the aims of the council and it will therefore actively consider appropriate ESG products as they emerge.

## **Proportionality**

Whilst the council is dependent on some profit generating investment activity from treasury management and commercial property investments to achieve a balanced revenue budget, this amounts to less than 1% of the overall gross revenue budget and therefore is considered proportionate. The assumptions around profit generating investment activity are reviewed as part of the annual budget monitoring process and, if necessary, revised as part of the following year's budget setting process.

The 2021/22 revenue budget includes a corporate contingency budget of £5.4m to mitigate against budget risks.

## **Borrowing in Advance of Need**

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. The authority has chosen to follow this guidance. However, If market rates were to fall considerably, or future rates were expected to rise, then some borrowing could be taken ahead of spend. The borrowing strategy will therefore consider opportunities to borrow not only for 2021/22 but ahead for the next two financial years.

### **Capacity, Skills and Culture**

**Elected members and statutory officers:** There are a number of procedures and processes that enable elected members and statutory officers to make appropriate investment decisions, including:

- All elected members and statutory officers are aware of the council's strategic objectives.
- Training on treasury management is available and can be tailored to needs.
- The council's constitution and financial regulations determine the authorisations required for investment decisions.
- Financial and legal implications (including statutory and regulatory frameworks) are required as part of all decision-making reports.
- The council has a multi-disciplinary governance process for reviewing budget proposals, including any future commercial investment proposals.
- Specialist external advice is sought and considered where it is deemed necessary.
- The council has an embedded risk management and reporting framework

**Commercial deals:** Financial and legal implications (including statutory and regulatory frameworks) are required as part of all decision-making reports. Specialist external advice is sought where appropriate to advise on commercial transactions. The council ensures external advisors are fully aware of the prudential framework and of the regulatory regime within which it operates.

**Corporate governance:** The authority's Annual Governance Statement details arrangements put in place to ensure accountability and responsibility for those making decisions and can be found here:

(<https://www.islington.gov.uk/~media/sharepoint-lists/public-records/finance/information/adviceandinformation/20202021/20201130201920annualgovernance1.pdf>).

### **Investment Indicators**

The authority has 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.

**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 the authority has issued over third-party loans. It is assumed that non treasury management investments remain at the same value as in the 2019/20 Statement of Accounts given that there are no current plans to increase/decrease these investments. The future investment exposure will however be affected by valuations in the Statement of Accounts, particularly in relation to investment properties.

*Table 5: Total investment exposure in £millions*

<b>Total investment exposure</b>	<b>31.3.20 Actual</b>	<b>31.3.21 Forecast</b>	<b>31.3.22 Forecast</b>
Treasury management investments	148.800	108.700	100.000
Service investments: Loans	1.905	1.905	1.905
Service investments: Shares	0.096	0.096	0.096
Commercial investments: Property	33.178	33.178	33.178
<b>TOTAL INVESTMENTS</b>	<b>183.979</b>	<b>143.879</b>	<b>135.179</b>
Guarantees issued on loans	0.017	0.017	0.017
<b>TOTAL EXPOSURE</b>	<b>183.996</b>	<b>143.896</b>	<b>135.196</b>

**How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. It is assumed the authority's investments are funded by usable reserves and income received in advance of expenditure, rather than borrowing.

**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. 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. Only the rate of return on treasury investments are included in the table below. The rate of return on other investments (e.g. service



loans/shares) is considered immaterial. Investment properties are not included as we do not hold the purchase cost (as explained earlier in the strategy).

*Table 7: Investment rate of return (net of all costs)*

<b>Investments net rate of return</b>	<b>2019/20 Actual</b>	<b>2020/21 Forecast</b>	<b>2021/22 Forecast</b>
Treasury management investments	0.82%	0.88%	0.50%