

## **Appendix 6 – Financial Overview and Indicators**

This appendix has been developed to cover the requirements of the 2018 Ministry of Housing, Communities and Local Government (MHCLG) Investment guidance, including investment indicators. Due to this being the first year of the BCP authority some previous year comparison has not been possible to calculate.

### **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 and generate other benefits such as employment and regeneration to the local area (known as **commercial investments** where this is the main purpose).

This appendix will focus 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 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.

**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 2019/20 for treasury management investments are covered in a separate document, the treasury management strategy.

### **Service Investments: Loans**

**Contribution:** The Council lends money to its subsidiaries, local business and residents to support local public services and stimulate local economic growth.

The most significant loan is to the Bournemouth Development Company LLP of £3.4m which was a loan to purchase a building situated on the proposed Winter Gardens development. The other partner in the partnership has also provided a matched £3.4m loan to the partnership. The loan supports the Council's long-term ambitions within the Bournemouth Town Centre Vision.

**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:

Should the Council want to increase the approved limits in the table below, relevant reports detailing the value and reason for these loans would go through the appropriate Cabinet and Council democratic process which in turn and following approval would adjust these limits accordingly.

**Table 1: Loans for service purposes**

Category of borrower	31/03/18 actual			2019/20
	Balance owing £'000	Loss allowance £'000	Net figure in accounts £'000	Approved Limit £'000
Bourenmouth Development Company LLP	3,400	0	3,400	3,400
Wholly owned Council Companies	550	0	550	1,000
Local Business	105	(46)	59	105
Local charities and trusts	220	0	220	220
Housing associations	42	0	42	42
<b>TOTAL</b>	<b>4,317</b>	<b>(46)</b>	<b>4,271</b>	<b>4,767</b>

Accounting standards require the Authority to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts from 2018/19 onwards will be 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.

The loans made to the Council's wholly owned subsidiaries were to ensure that the working capital for the companies can be maintained. The loans are given at a rate that is compliant with EU regulations in respect of State Aid and reflect the level of risk involved. These working capital loans are being reduced year on year as the companies establish themselves. As the companies are wholly owned and managed by the Council an assessment of risk is carried out as part of its normal financial processes.

The following bullet points cover the further areas the Council would consider as part of its risk assessment:

- State Aid considerations to establish the minimum interest rate and compliance with State Aid criteria.
- Assessment of cash flow forecasts and relevant income streams – if available
- Consideration of the company structure. Any limitations which may affect the distribution of assets, company control and distribution of surpluses from the entity
- A review of the company accounts, business plan and cash flows to assess the risks of the company's key sources of income (including volatility and consistency of any forecast income).
- An appraisal of the loan terms to determine if the implicit rate in the agreement is at a commercial/market rate to ensure there are no state aid issues associated with the arrangement
- A full assessment of the ability of the entity to service the finance agreement and their underlying credit quality and risk of default.
- Assessment of the collateral which is provided as security for the loans.
- Assessment as to whether the Market Operator Principle can be applied to the loans proposed
- A review of the relevant credit references, existing charges and debt obligations.
- Advice on the level and/or value of the relevant loan covenants and an explanation for the levels and associated risk.

- The identification of any relevant matters of a legal or accounting nature which may have implications for the manner in which it is proposed to make the loan.
- The identification of alternative powers that may be relied upon by the Authority to support the making of the loan, together with a detailed explanation of factors that would enable an alternative power to be considered and adopted by the Authority.

The Council would also look to consult with its external Treasury Management advisors to help support the items above.

### **Commercial Investments: Property**

MHCLG defines property to be an investment if it is held primarily or partially to generate a profit.

**Contribution:** The Council invests in local commercial and residential property with the intention of making a profit that will be spent on local public services.

The most significant property investment to date was in the Mallard Retail Park in Bournemouth at a cost of circa £49m. This property investment was driven by not only providing a sound investment for the Council but also ensuring the safeguarding of a key employment and economic site within Bournemouth. It is projected to provide an extra £600k (net of borrowing and other costs) a year towards helping to safeguard existing services for residents and businesses.

**Table 2: Property held for investment purposes**

Property	Actual Purchase cost £'000	31/03/18 actual	
		Gains or (losses) £'000	Value in accounts £'000
Mallard Road Retail Park	49,065	(2,190)	46,875
Madeira Road Student Accommodation	18,734	6,736	25,470
Citrus Building, ground floor Turtle Bay	1,338	15	1,365
Wessex Trade Centre	9,960	0	10,570
Dolphin Centre	Historic	0	12,210
Saxon Square	Historic	0	1,380
Airfield Industrial Park	Historic	0	3,994
<b>TOTAL</b>	<b>79,097</b>	<b>4,561</b>	<b>101,864</b>

**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 2018/19 year end accounts preparation and audit process value the portfolio of properties below the total portfolio 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. (For information the Mallard Road and the Wessex Trade Centre the total purchase cost also included Stamp Duty Land Tax and other due diligence fees which are over and above what is taken into account for valuation purposes and show as a downward loss until the asset is revalued in future years based on rent receivable.)

**Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding property investments by identifying the key risks associated with these type of investments:

### **Acquisition Risks:**

The current low yields from traditional investments, such as bonds, mean that there is strong competition in the property market for investment opportunities. It follows that it is highly likely that there will be several bidders for any good-quality asset. One factor that is increasingly emerging is competition amongst local authorities looking to invest on a nationwide basis. This increased competition means it is inevitable that some bidders will be unsuccessful and it also raises the possibility of local authorities distorting the investment market, driving up prices fuelled by the availability of low-cost borrowing.

Due to the nature of the property market, decisions may need to be taken quickly in order to put offers forward. Of course, offers can be subject to conditions and due diligence before exchange of contracts.

### **Cost Risks:**

Abortive costs, including legal costs, survey fees, professional adviser's fees, and officer time, may be incurred in connection with initial feasibility investigations and unsuccessful bids. It is also possible that issues will be identified during due diligence that will prevent a transaction from progressing.

### **Property Market Risks:**

Property has a different risk profile from other investments because of its physical characteristics, which need to be managed and maintained. Whilst most property sectors have historically demonstrated good long-term returns, particularly in relation to underlying capital growth, fluctuations in the market or local economy and tenant/property-specific issues can affect short-term returns. The property market is not a certain market and the Council may not always achieve its target returns.

Many investment transactions happen without being offered for sale in the market. These are known as off-market transactions. Information is key and getting to know about properties for sale is important and as it becomes known that a purchaser is active in the investment market, many such opportunities are presented by agents seeking a finder's fee, usually a maximum of 1% of the purchase price. Alternatively, the investor can be proactive by contacting property owners and agents directly. Consideration can also be given to engaging a specialist investment agent to act on the investor's behalf.

Lack of suitable sites/buildings – the local property market is restricted and is dominated by secondary or tertiary assets that may not be of the quality the council would acquire. There may therefore be a shortage of suitable stock in the conurbation.

**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. The investments made to date are either historic properties held by the Council for a number of years or are new investments with a view to retain for the foreseeable future. Although liquidity is important, no investments made to date affect the ongoing liquidity of the organisation.

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

**Elected members and statutory officers:** The new Council proposes to operate an Asset Investment board which consists of elected members and statutory officers. Their role will be to look at potential investments as well as manage the current portfolio. The board will make recommendations to Cabinet and Council for any future investments.

**Commercial deals:** Specialist staff are employed by the Council to ensure the knowledge and skills are held in house when dealing with significant commercial deals. The Council also consults with specialist firms for further independent advice. At all-times officers from the Council ensure that all commercial deals follow the principles of the prudential framework and of the regulatory regime within which Local Authorities operate.

**Corporate governance:** This has been covered in the preceding Asset Investment Strategy.

## 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.

**Table 3: Total investment exposure**

<b>Total investment exposure</b>	<b>31/03/18 Actual £'000</b>	<b>31/03/19 Forecast £'000</b>
Treasury management investments	68,997	70,000
Service investments: Loans	4,271	4,000
Commercial investments: Property	79,084	79,084
<b>TOTAL INVESTMENTS</b>	<b>152,352</b>	<b>153,084</b>
Commitments to lend	0	0
Guarantees issued on loans	0	0
<b>TOTAL EXPOSURE</b>	<b>152,352</b>	<b>153,084</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. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

**Table 4: Investments funded by borrowing**

<b>Investments funded by borrowing</b>	<b>31/03/18 Actual £'000</b>	<b>31/03/19 Forecast £'000</b>
Treasury management investments	0	0
Service investments: Loans	0	0
Commercial investments: Property	73,710	73,710
<b>TOTAL FUNDED BY BORROWING</b>	<b>73,710</b>	<b>73,710</b>

**Table 5: Other investment indicators**

<b>Indicator</b>	<b>2017/18 Actual</b>	<b>2018/19 Forecast</b>	<b>2019/20 Forecast</b>
Debt to net service expenditure ratio	N/A	N/A	36%
Commercial income to net service expenditure ratio*	N/A	N/A	1%

*\*Commercial Income is only in relation to properties which have required borrowing to fund initial purchase.*