Purpose
To consider the work programme for the Treasury Management Sub-Committee in order to give effect to the recent changes to its Terms of Reference, in respect of non-cash investments. This report and appendices are designed to facilitate an initial discussion to establish what information will be required by the sub-committee at future meetings to enable it to carry out its expanded role to:

(i) monitor non-cash investments in the same way that it is does for cash investments, and
(ii) to comment on and make recommendations to Cabinet on the Investment Strategy

Recommendations
It is recommended that the Treasury Management Sub-Committee considers the report and appendices, and the information requirements for future meetings, and agrees the next steps/programme of work set out in the report.
1. Background

1.1. On 13 May 2020, the Council considered, and approved, changes to the Terms of Reference for the Treasury Management Sub-Committee (TMSC), recommended by the Governance Committee. As the TMSC is a sub-committee of the Audit and Risk Committee, it was appropriate to consult with the Committee about the changes and the report attached at Appendix 1 was circulated to Audit and Risk Committee Members alongside the proposed changes to the Terms of Reference. Comments received were fed back via the Chair of Audit and Risk, to the Chair of Governance Committee. The new Terms of Reference are included at Appendix 2.

1.2. The key change to the TMSC’s Terms of Reference was to expand the remit of the Sub-Committee to include non-cash investments such as commercial property, in addition to the cash investments already considered by the Sub-Committee under the Treasury Management Strategy. The Sub-Committee would then be able to comment on both the Treasury Management and the Investment Strategy moving forward and make recommendations to Cabinet on these Strategies.

1.3. The reasons for bringing consideration of both cash and non-cash investments together were set out in the report and included reference to investment guidance and increasing the understanding of the risk profile of the Council’s investment portfolio. This was summed up in the conclusion as follows:

“The current system of strategy development and monitoring of cash investments by the Sub-Committee works well and it would be appropriate to extend this to other forms of non-cash investment. The overlap between the Treasury Management Strategy and the Investment Strategy, and the knowledge and skills required to develop them, would also support bringing these two strategies together. In addition, developing a suite of indicators to monitor property investment returns will add a robust level of scrutiny to the performance of the Council’s investment portfolio.”

2. Current Strategy

2.1. The Capital and Investment Strategy approved at Council in February 2020 set out some high-level data in respect of the Council’s commercial property portfolio including segmental analysis, acquisitions and disposal in year and valuations. It also set out the principal risk of holding these investments such as:

- Investments funded from borrowing expose the Council to risk that the income generation from schemes is less than the cost of repaying the borrowing.
- Such investments must be proportional and do not concentrate risk in one particular sector or activity.
- Capital appreciation may not occur, and the value of the investment could fall in real terms.

2.2. Other key points raised in the Strategy were that:
Agenda Item 6

- the Council would monitor the value of its investment property and the security of the related income
- that commercial investments should remain proportionate to the size of the authority
- compared to other forms of investment, and depending on the prevailing market conditions, investment in property can take time to sell and therefore the Council undertakes these investments on the basis that they are medium to long term in nature

2.3. It should be noted that the investments to be included in the monitoring arrangements do not include the development of land holdings by the Council or purchase of assets to support service delivery such as temporary or affordable housing. The investments to be covered here are direct commercial investments entered into for financial return. Some of these commercial property investments have a dual purpose in that they also support local economic objectives, such as supporting SMEs, but it is still important to monitor the financial performance of such assets.

3. Proposal

3.1. The current Strategy will be required to be reviewed by Council in February 2021. For the TMSC to feed into that Strategy development, it needs to be provided with sufficient information to enable it to understand the Council’s investment property portfolio and associated risks.

3.2. Appendix 3 provides some initial information to provoke discussion on the potential criteria to be set within the Strategy and suggests key data that may assist the Sub-Committee in its monitoring of investments. The aim will be to build these into a framework of reporting so that the TMSC receives a draft Strategy ahead of the new financial year, a mid-year report and an outturn report, just as it does for cash investments.

3.3. Members are asked to consider the suggested criteria and information requirements set out in Appendix 3 and determine what data officers need to provide to subsequent meetings in order for the Sub-Committee to be able to robustly scrutinise non-cash investments, and make recommendations on the draft strategy to be presented to the Sub-Committee later in the financial year.

4. Conclusion

4.1. The aim of the report is to establish what information will be required by the sub-committee at future meetings to enable it to carry out its expanded role.

4.2. The proposed work programme for TMSC in relation to monitoring non-cash investments and strategy development is as follows:
**Agenda Item 6**

<table>
<thead>
<tr>
<th>Date</th>
<th>Activity/Objective:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial preparatory work culminating in draft Strategy 2021/22:</strong></td>
<td></td>
</tr>
<tr>
<td>Jun 2020</td>
<td>Review suggested data and confirm requirements for next meeting</td>
</tr>
<tr>
<td>Oct 2020</td>
<td>Receive monitoring data, agree indicators/data/criteria to be included in Investment Strategy 2021/22</td>
</tr>
<tr>
<td>Dec 2020</td>
<td>Consider draft Investment Strategy 2021/22 and make recommendations to Cabinet</td>
</tr>
<tr>
<td><strong>On-going reporting pattern:</strong></td>
<td></td>
</tr>
<tr>
<td>June</td>
<td>Consider outturn report for recommendation to Cabinet</td>
</tr>
<tr>
<td>Oct</td>
<td>Consider mid-year report for recommendation to Cabinet</td>
</tr>
<tr>
<td>Dec</td>
<td>Consider draft Investment Strategy and make recommendations to Cabinet</td>
</tr>
</tbody>
</table>

**List of appendices:**
- Appendix 1 – Consultation report circulated to Audit and Risk Committee 24 April 2020
- Appendix 2 – Treasury Management Sub-Committee Terms of Reference
- Appendix 3 – Discussion document – example investment criteria and data sets

**Background papers:**
None

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**Corporate Implications**

Legal/Constitutional: The Council is required to produce an annual Investment Strategy and have due regard to investment guidance

Financial: The setting of performance indicators or monitoring criteria will enable robust monitoring of the financial performance of non-cash investments


Contribution toward achieving a net zero carbon position by 2030: As above

Personnel: None

Risk Management: The Investment Strategy should be set taking account of the risk appetite of the Council. Risk mitigation is provided by on-going monitoring of investment returns.

Equality and Diversity: None

Health and Safety: None

Digital: None
Other: None

Consultees: None

Relevant Policies and Strategies:
Capital and Investment Strategy 2020/21
AUDIT AND RISK COMMITTEE
24th April 2020

Subject | TREASURY MANAGEMENT SUB-COMMITTEE TERMS OF REFERENCE
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Report by | DIRECTOR OF FINANCIAL SERVICES

Enquiries contact: Amanda Fahey, 01245 606401, amanda.fahey@chelmsford.gov.uk

Purpose
To consider expanding the remit of the Treasury Management Sub-Committee of the Audit and Risk Committee, to include the monitoring of “non-cash” investments such as commercial property and to update the Terms of Reference of the Sub-Committee in respect of membership.

Recommendation(s)
1. The Audit and Risk Committee recommend to Council the expansion of the remit of the Treasury Management Sub-Committee and the revised Terms of Reference as set out at Appendix 1 [the agreed TOR are now shown at Appendix 2]

Corporate Implications

Legal:
The Council is required to produce an Investment Strategy under the Ministry for Housing, Communities and Local Government’s (MHCLG) Statutory Guidance on Local Government Investments. Councils are also required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) publications The Prudential Code for Capital Finance in Local Authorities and Treasury Management in the Public Services.

Financial:
A robust investment strategy is essential in the delivery of the Council’s objectives over the medium-term, and in managing the risks and opportunities inherent in investment transactions. Monitoring should be undertaken to ensure delivery of the strategy.

Personnel:
None

Potential impact on climate change and the environment
The Council’s Climate and Ecological Emergency Action Plan as agreed at Cabinet 28th January 2020 included review of the Council’s investment strategy in light of the Climate and Ecological Emergency Declaration.

Contribution towards achieving a net zero carbon position by 2030:
As above
<table>
<thead>
<tr>
<th>Risk Management:</th>
<th>The Investment Strategy should be set taking account of the risk appetite of the Council. Risk mitigation is provided by on-going monitoring of investment returns.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equalities and Diversity:</td>
<td>N/a</td>
</tr>
<tr>
<td>Health and Safety:</td>
<td>None</td>
</tr>
<tr>
<td>IT:</td>
<td>None</td>
</tr>
<tr>
<td>Other:</td>
<td>None</td>
</tr>
</tbody>
</table>

**Consultees**

| Cabinet Member for Fairer Chelmsford |

**Policies and Strategies**

The report takes into account the following policies and strategies of the Council:

- Capital and Investment Strategy
- Treasury Management Strategy

1. **Background**

1.1 The recent rapid expansion of commercial property purchases by local authorities has prompted concern from Government, Cipfa and others particularly in regard to borrowing to fund such investment.

1.2 Guidance comes in the form of the Prudential Code, MHCLG Guidance on Local Investments, Guidance on Minimum Revenue Provision (MRP) and most recently Cipfa’s informal guidance on “Prudential Property Investment”.

1.3 Since 2019/20, Councils have been required to produce a Capital and Investment Strategy, which is expected to provide some detail around the governance and monitoring arrangements for non-cash investments (such as property) and Chelmsford’s 2020/21 Strategy mentions a proposed review of governance and monitoring arrangements for the coming year.

2. **Why do we need to respond?**

2.1 Many local authorities have undertaken investment in commercial property to supplement their revenue budgets, especially given the perceived need to act “more commercially” and become more self-reliant in the face of central funding cuts. Concerns have stemmed from the increased use of borrowing to fund such purchases, given the Prudential Code’s statement 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.

2.2 Key areas for the Council to consider are:

- whether the Council is having due regard to the regulatory and advisory framework and is acting under the correct legal powers
- whether the risks are understood, in terms of incurring borrowing costs in exchange for potentially uncertain returns
- whether the increasing use of borrowing to fund such investment could provoke statutory intervention rather than continued reliance on the self-regulatory prudential code (and therefore usher in a more restrictive regime)

2.3 Clarifying the framework for decision-making and improving the reporting of non-cash investments, will support the Council in demonstrating that it has considered the risks inherent in these transactions, and set an Investment Strategy commensurate with its...
risk appetite. It will demonstrate decision-making based on relevant data and provide an opportunity for scrutiny of the investments, in the same way that cash investments are currently scrutinised by the Treasury Management Sub-Committee of the Audit and Risk Committee.

3. **The proposal**

3.1 It is proposed to extend the Terms of Reference of the Treasury Management Sub-Committee to encompass both cash and non-cash investments. The Sub-Committee currently reviews the Council’s Treasury Management Strategy annually and makes recommendations to Cabinet, for onward approval at Council. The Council has appointed it as the designated body which considers treasury matters under Cipfa’s Treasury Management Code of Practice.

3.2 In addition to reviewing the annual strategy, the Committee receives both a mid-year and end of year report prior to consideration by Cabinet and Council. These reports contain Treasury Management indicators which set limits for cash investments both in terms of monetary amounts and strength of counterparties, and the monitoring of these indicators ensures adherence to the approved strategy and provides opportunity for an appropriate level of scrutiny. As commercial investment increases, it is notable that this area of investment, whilst being subject to the Capital and Investment Strategy annual approval process, does not have the same level of scrutiny during the year to ensure it is meeting the Strategy requirements.

3.3 Bringing together the Investment Strategy and the Treasury Management Strategy and taking them through the same route, provides some consistency in method of scrutiny, utilises a similar knowledge and skillset as required for Treasury matters and improves transparency. A key part of this role could be to help determine the indicators that the Council wishes to use to monitor its investment property portfolio, having regard to the suggested range of indicators included in the Investment guidance while ensuring these are the right measures to use locally. As commercial property income is a key source of revenue income for the Council, supporting its core service delivery, it is important that there is some focus on the risks arising from this, and that the Council’s Strategy is formed in light of both the risk and returns, in the same way that the Treasury Management Strategy seeks to find a balance between risk and return, taking into account the security, liquidity and yield available.

3.4 Minor adjustments may be made to the Constitution under delegation to the Monitoring Officer, while more significant changes are required to go through the Governance Committee before ultimate approval by full Council. For this reason, and due to timing of meetings, the proposed changes have already been considered by the Governance Committee meeting of 11th March and are scheduled to be presented to the full Council meeting of 13th May for final approval. The Governance Committee report however, included a delegation to the Chair to make any amendments to the onward report, following consideration of the changes to the Terms of Reference for the Treasury Management Sub-Committee by the Audit and Risk Committee. This report therefore seeks the views of the Committee on the proposed Terms of Reference so that any feedback can be supplied to the Chair of Governance ahead of the Council meeting.

3.5 If these changes to the Treasury Management Sub-Committee’s Terms of Reference are approved by Council, the Director of Financial Services will then schedule work into the meetings to prepare indicators and meet reporting requirements.

3.6 In addition to expanding the remit to cover a wider definition of investments, the Terms
of Reference as set out in the current Constitution require updating to reflect current practice and political balance. It is therefore recommended to amend the membership from three to five, with three Members being drawn from the Audit and Risk Committee.

4. Conclusions

4.1 The current system of strategy development and monitoring of cash investments by the Sub-Committee works well and it would be appropriate to extend this to other forms of non-cash investment. The overlap between the Treasury Management Strategy and the Investment Strategy, and the knowledge and skills required to develop them, would also support bringing these two strategies together. In addition, developing a suite of indicators to monitor property investment returns will add a robust level of scrutiny to the performance of the Council's investment portfolio.
# Treasury Management and Investment Sub-Committee
## Terms of Reference

<table>
<thead>
<tr>
<th>Membership: Seven Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quorum</td>
</tr>
<tr>
<td>THREE</td>
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</table>

## Functions/Purpose

1. To comment on the draft Treasury Management and Investment Strategies and make recommendations to Cabinet on those Strategies.
2. To receive reports on Treasury Management and Investment activities and performance three times per year.
3. To report to the Audit and Risk Committee on any breaches of Treasury Strategy, Investment Strategy or Treasury Management Procedures.
4. On occasion of urgent matters to agree changes to the Treasury Management or Investment Strategy without reference to Full Council.
5. In the light of performance and market conditions recommend changes to either strategy going forward.
6. The sub-committee is not intended to be a consultee to individual investment decisions.

## Procedures

- Part 4.2 – Cabinet and Committee Procedure Rules
- Part 4.9 – Financial Rules

## Codes

- Part 5.1 – Code of Conduct for Councillors
Discussion Document for developing Chelmsford City Council investment strategy.

Central Government has responded to the rise of property investment transactions undertaken by local authorities, particularly regarding borrowing for such investments. MHCLG and CIPFA have both published guidance notes on this matter which has since 2019/20 required Local Authorities to produce an investment strategy which should provide guidance and details of governance and monitoring arrangements for non-cash investments such as property.

Chelmsford City Council has for many years held and managed a range of commercial property. In recent years this has been extended to provide a revenue stream to support the Council’s budget and to aid economic development in the City. The decision to invest has been based on assessment of the opportunities as they arise, and the purpose of this document is to outline suggested investment criteria for Chelmsford City Council’s property purchases together with the details that will be included in a half-yearly monitoring report.

Investment Criteria

Set out below are some suggested core strategy objectives for the Council’s direct commercial property investments.

- Assets should be located within the City and support or further the development of economic activity.

- Commercial property investments should generate an immediate income, secured through legal agreements let on commercial terms, or from properties which are contracted to be let.

- Assets should provide an income yield (return) with a clear margin over the cost of capital, in a form which is sustainable, and has the potential to increase through future rental growth.

- Assets will be selected to achieve an even balance of risk and return through portfolio diversification.

- The aim will be to acquire investment grade properties where possible that possess characteristics that retain liquidity and preserve capital (notwithstanding market movement)

- Lot size should be between £3m and £10m.

- Single occupancy investments let to institutional tenants will be preferred in order to minimise management expense and risk. Multi-let properties or multi-unit schemes may be considered if all other criteria are met.

- Investments will be considered if the income is secured by existing tenants with a low-risk or medium-risk financial profile. The financial strength of existing tenants will be analysed considering company accounts and the use of appropriate methods of risk assessment and credit scoring such as Dun & Bradstreet reports.

- Assets that offer opportunities to increase value and income through asset management initiatives should be considered provided that all other criteria are met.
The Current Portfolio

The Council’s property investment portfolio consists of 15 income-producing assets that provide an annual income of over £5m. The assets that make up this holding may have been purchased for other purposes such as to support small and local business rather than as investments, but the characteristics of these assets are such that we believe that they should be reported here. Internally we have assessed the portfolio’s value to be £82.1m following our latest acquisition of the Aquarium earlier this year.

The single largest asset held by the Council is High Chelmer Shopping Centre which accounts for over half of the investment income and value. Naturally, this distorts the sector analysis shown below and makes it difficult to show a balanced sector split.

![Portfolio by Sector (Value)](image)

Investment Portfolio Reporting Criteria.

Performance reporting will be undertaken twice a year and the Estates Team will produce a performance report for the portfolio to include details of:

- any changes in the portfolio in the period (acquisitions and sales)
- all charges and receipts, indicating any arrears.
- capital expenditure, planned or reactive.
- performance against budgets both expenditure and income.
- any potential changes to the income through lease renewals and rent reviews.
- any changes to Dunn and Bradstreet rating of tenants.