City of Westminster

Decision Maker:	Cabinet
Date:	13 February 2023
Classification:	General Release
Title:	Integrated Investment Framework 2023/24
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently.
Cabinet Member	Cllr David Boothroyd
Financial Summary:	An Integrated Investment Framework will influence investment decisions going forwards and deliver added value to Council services. This report identifies the potential for future improved returns.
Report of:	Gerald Almeroth, Executive Director of Finance and Resources

EXECUTIVE SUMMARY

1. On 2 March 2022, Full Council gave approval to its previous comprehensive strategic integrated investment framework for bringing together and managing its investments with the approval of an Integrated Investment Framework.

2. The framework referred to targeting an overall return on council investments of at least annual CPI inflation. The 2022/23 financial year has seen a spike in inflationary pressures not seen for 40 years due to several factors, including the invasion of Ukraine, pressure on labour markets, high energy prices, and disruptions to global supply chains. CPI inflation rose to a peak of 11.1% in October 2022 and has since fallen to 10.7% in November 2022. From mid-2023, it is expected to fall sharply as previous price rises drop out of the annual comparison, ultimately heading to below the 2.0% target. Accordingly, it is proposed that the target of matching returns with CPI inflation be linked to medium term inflation forecasts.

3. The Council holds £1.263bn of short-term high grade, cash investments (as at 31 December 2022), managed under the Council's Treasury Management Strategy, which passes through Audit and Performance Committee, Cabinet and Full Council on an annual basis. The Council also owns a significant number of investment properties, currently valued at £463m. It also owns various equity shareholdings, with investments in Westminster Housing Investments Ltd of £38m and investments in a property fund partnership of £28.5m (30 September 2022 valuation). In addition, the Council is responsible for managing the Westminster City Council Pension Fund which has net assets of £1.78bn (30 November 2022 valuation) and operates under the Fund's Investment Strategy Statement (ISS) set by the Pension Fund Committee.

4. The treasury investment portfolio is currently generating a return of 3.00% (at portfolio date 31 December 2022) in the current financial year 2022/23. The investment properties are currently generating around 4.33%, net of direct costs (based on the final accounts for 2021/22). The latest current inflation rate as measured by CPI is 10.7% (as at November 2022), and this must be accounted for alongside the current total portfolio yield.

5. This Investment Framework sets out:

   - the Council's strategic objectives in respect of risk management, and its attitude towards investment risk;
   - current levels of investment activity;
   - an updated Integrated Investment Framework for the Council going forward which seeks to diversify the risk and thus future proof the Council against possible future economic downturns;
   - actions to be taken in connection with implementing this framework.

RECOMMENDATIONS

6. Cabinet is asked to recommend that Full Council:

   a) approve and implement the Integrated Investment Framework set out in this report;

   b) approve that the target for the overall return on Council investments should aspire to at least meet forecasts for inflation over the medium term;

c) approve that the benefits of investing in the Pension Fund should be used as a benchmark when evaluating other investments;

d) adopt the asset allocation percentage ranges set out in the framework and work towards achieving these;

e) agree that the overarching objective of this framework is to achieve an overall return on Council investments, matching CPI inflation over the medium term, and to reduce costs and liabilities, while maintaining adequate cash balances for operational purposes, and not exposing the capital value of investments to unnecessary risk;

f)Agree that assets must only be acquired for strategic purposes. Such prospective acquisitions must be considered individually, with the reasons for investment limited to regeneration or development of the location, or other strategic purposes in which the asset is established. Out-of-borough acquisitions may also be considered by exception;

g) the Investment Executive to implement, monitor and report on the investment strategy.

INTEGRATED INVESTMENT FRAMEWORK

BACKGROUND

7. The Council is responsible for managing its total assets valued at around £3.725bn at 31 December 2022, comprising £1.780bn pension fund (as at 30 November 2022), £1.263bn short-term cash investments, £38m in Westminster Housing Investments Ltd, £28.5m in a property fund partnership and £463m of investment commercial property. It is important that the Council can take a holistic view of its investment and align them with its funding needs and goals. The scale of these figures makes their positive and proactive financial management very important. Investments held as part of the Council's pension fund are managed under a separate regulatory framework and are outside the scope of this report from the point of view of investment management.

8. In previous years, the Council's Investment Strategy formed part of the Treasury Management Strategy Statement (TMSS) which is developed and updated as part of the Council's Medium Term Financial Plan (MTFP). The TMSS has tended to focus on the policies for placing short-term cash investments, while decisions regarding other types of longer-term investment have been considered on an individual basis as opportunities arose.

9. While the assets are distributed across a range of areas, the complexity of the Council and its funding requirements mean that there is a need for the assets to be considered collectively and holistically as, in the aggregate, they represent a very significant pool of resources. More specifically, in view of:

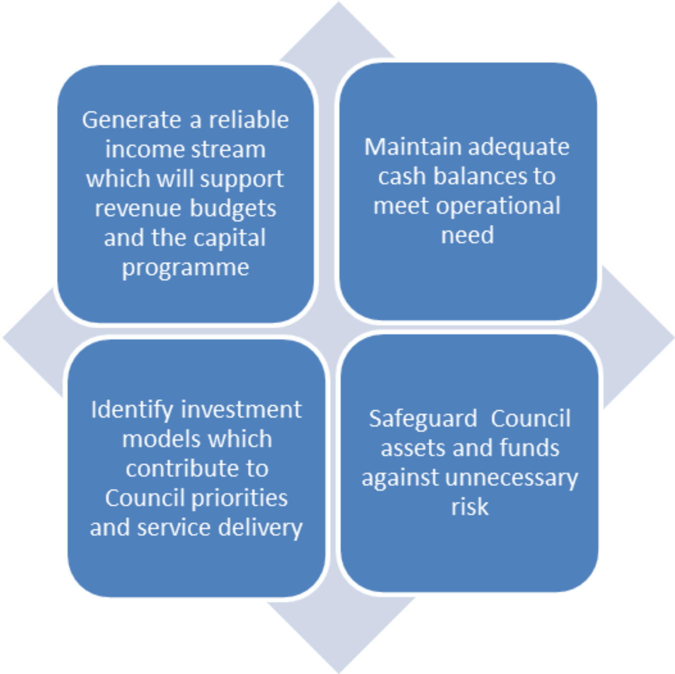
   - the significant value of investments held by the Council;
   - their increasing importance in terms of generating income which supports revenue budgets and capital investment;
   - their potential to add value and contribute towards corporate objectives in their own right,

   it was felt appropriate to give this aspect of financial management more detailed consideration and to develop a more integrated approach to investment decision making.

STRATEGIC CONTEXT

10. The Council's key focus is on delivering high quality services within the context of reduced government funding and increased demand for services due to demographic change. The Council also needs to have regard to the longer term, given its moral and legal responsibilities regarding sustainability and stewardship of public assets.

11. The role of investment management is to support service delivery by balancing four key strategic objectives as follows:



12. An appropriate investment strategy which balances the above objectives is therefore key.

13. The Council is exposed to possible future events, such as:

- the global financial instability resulting from the Russian invasion of Ukraine is likely to continue to pose various challenges;
- supply chain issues in the short term which will likely continue to contribute to lower UK and global GDP growth rates;
- short-term inflation pressures: the CPI inflation rate was 10.7% in November 2022 and will likely remain relatively high in the short-term, and;
- continuing pressures on local authority expenditure and service revenue streams.

14. Ideally, the investment strategy should be aimed at generating future income to mitigate against these risks and seek medium and longer term stability with the Councils finances.

ACCEPTABLE RISK LEVELS

15. An appropriate investment strategy which balances the above objectives consists of one which:

- focuses on investments with a reasonable return based on reasonable risk;
- includes other Treasury opportunities not covered in the TMSS; and
- investigates commercial property where regeneration or area redevelopment is the primary purpose of acquisition.

16. The suggested policy going forward is that the Council will generally seek to obtain the maximum amount of income consistent with an optimum level of risk and will be willing to accept a lower level of income in exchange for a lower risk product which does not expose the capital value of the investment to future potential loss.

17. By more proactive and appropriate management of the Council's investment portfolio, an increased level of income can be achieved, while also ensuring that appropriate security is maintained over the Council's assets.

18. Such investments shall be separately identified in Council records and will be subject to the Council's detailed budget monitoring and review as a result.

19. Guidance from the Department of Levelling Up, Housing and Communities (DLUHC) and CIPFA places a high priority on the management of risk. The Council has adopted a careful and prudent approach to the investment process.

CURRENT INVESTMENT ACTIVITY

20. The Council is responsible for managing five investment portfolios:

- the Council treasury investment portfolio of £1.263bn short-term cash-based investments generating a return of 3.00% as at 31 December 2022;
- long-term investments in shareholdings, such as Westminster Housing Investments Ltd, portfolio value £38m, with an expected return of 5%;
- a property fund partnership lettings fund £28.5m (book cost £29.6m) with a long-term expected rate of return of 6.0%;
- the investment property portfolio of £463m (valuation at 31 March 2022), currently generating a net of costs return of 4.33%, and;
- Westminster City Council Pension Fund of £1.780bn (valuation at 30 Nov 2022), with an assumed long-term investment return of 4.8%.

21. The Council investment portfolio (excluding the pension fund) is set out below.

Type of Investment	Expected rate of return	Value at 31 December 2022 £ million	Value at 31 March 2022 £ million
Short term investments (mostly overnight cash deposits, money market etc.)	Between 2.5% and 3.5% in financial year 2022/23	£1,263	£383.4
Long term investments in cash-based investments, shareholdings and controlled companies	5% Average	£38.5	£55.9
Property Fund Partnership (Lettings Fund)	6% average over 7 years	£28.5	£27.7
Investment properties	4.33%	£463	£463
Total		**£1,793**	**£930**

22. Throughout 2022/23 the Council has received several large deposits. These included a forward loan agreed in 2019/20 totaling £150m, non-domestic rates of £92m, and £30m in special project receipts. Additionally, the Council will be making a section 31 payment of £439m before the end of the financial year 2022/23, which will significantly reduce the total cash balance.

23. The Pension Fund is a separate legal entity and, therefore, its assets cannot fit within the wider investment framework of the Council. However, despite this ring-fencing, the pension fund has a significant second order impact on the Council's financial position and funding needs because of the possibility of future deficits in the scheme, and the contribution plan that would be required to close any future deficit.

24. Following the 2019 triennial actuarial valuation, as performed by Barnett Waddingham, the funding level for the Westminster City Council Pension Fund rose to 99.0% (80.0% in 2016). The Council, as an employer, had a funding level of 86% in 2019, with deficit recovery payments of circa £103m committed to the Pension Fund during 2021/22. The 2022 valuation as performed by Hymans has resulted in a funding level for the Westminster City Council Pension Fund of 128%. The Council, as an employer, had a funding level of 111% in 2022, with no deficit recovery payments required from 1 April 2023.

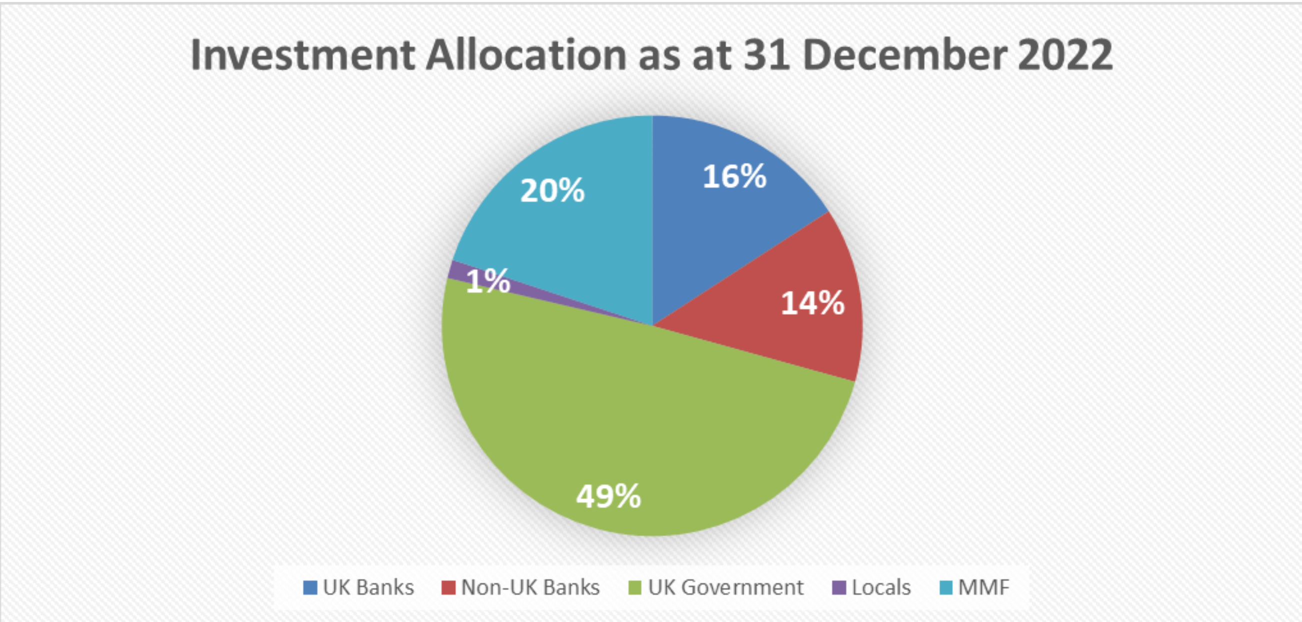
25. Hymans' approach to the actuarial assumptions is broadly in line with the previous Barnett Waddingham valuations.

26. The main drivers for this funding improvement are the significant investment returns and additional deficit recovery payments received from the Council.

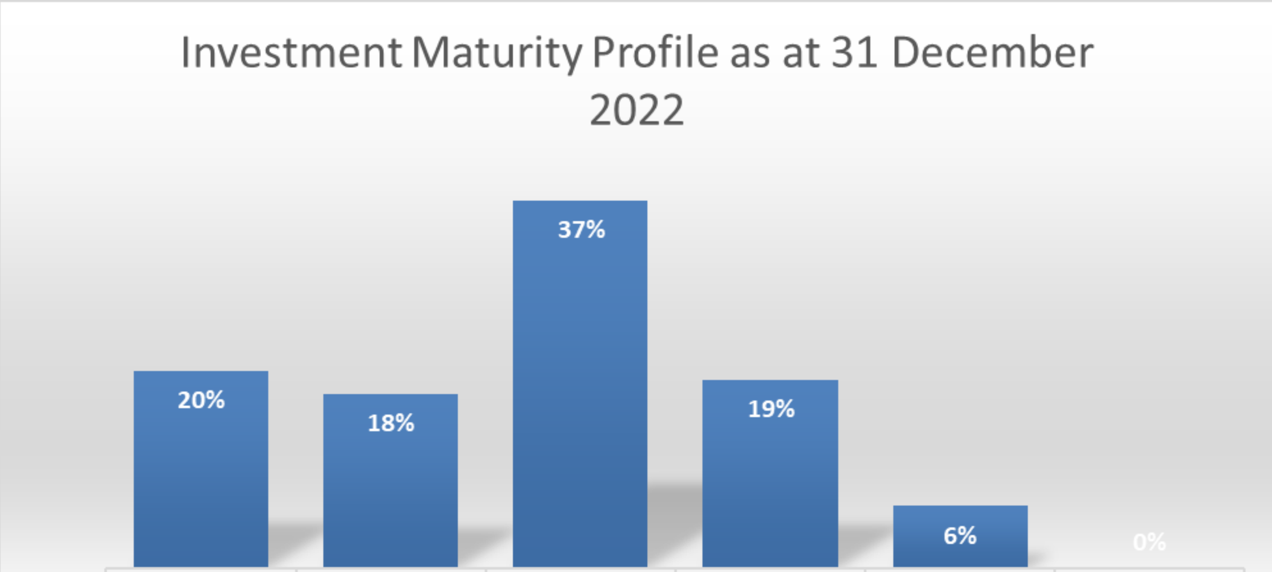
27. The real discount rate, a proxy for the real investment return, is anticipated to remain stable at 4.8%. The discount rate is set with reference to the likelihood of the Fund's investment return achieving a certain level of return over the next 20 years. The actuarial analysis suggests a long-term trend of 1.5% annual improvements in longevity, when adjusted for the LGPS this leads to a reduction in liability values. The Council's primary contribution rate for the next three years will remain at its current rate of 16.8%.

SHORT-TERM INVESTMENTS

28. In line with the current investment strategy, the treasury portfolio of short-term cash-based investments with 30% bank-based deposits, 1% in local authorities, 20% in money market funds and 49% in the Debt Management Office and Treasury Bills as shown below.



29. Most treasury managed investments currently mature within three months as set out below:



	Daily Liquidity	Within 1 Month	Within 3 Months	Within 6 Months	Within 12 Months	> 12 Months
Total	20%	18%	37%	19%	6%	0%

30. In line with the above, the portfolio is entirely investment grade and heavily biased toward the top end with 20% of investments rated AAA, 11% rated AA, 18% rated A and 51% being local authority and UK government. Local authority investment is subject to due diligence on recent financial statements, external audit reports, current expenditure forecasts and current/anticipated position regarding useable reserves.

31. This approach provides flexibility for the Council at low levels of risk, but tends to result in lower returns, currently around 3.00%, and an approach to investment management which focuses on capital security and liquidity. The various BoE Bank Rate increases throughout 2022 will result in significant improvements in the final figures for investment performance for 2022/23 compared with the previous year.

32. The Base Rate is currently at 3.5% with a slight further upward trajectory predicted, which will earn the Council upwards of £20m treasury income in 2022/23. The Base Rate is projected to fall as CPI inflation falls back towards its target of 2.0% and investment income in 2024/25 and beyond will fall accordingly as the Base Rate falls and cash balances reduce.

INVESTMENT PROPERTY

33. Commercial property investment provides the Council with:

- a higher income return than equities, bonds or cash;
- a secure, regular income with income growth prospects to hedge against inflation;
- capital value appreciation;
- asset management opportunities to further increase rental and capital growth, and;
- an underlying real asset with minimum capital value.

34. However, as with any investment, there are associated risks:

- illiquidity: property is a ‘bricks and mortar’ asset which takes time to sell/buy;
- threat to income security if the tenancy fails and the property cannot be re-let;
- capital depreciation: if the asset is not properly managed and kept in good repair, and;
- fallout from current economic downturn: resulting in rental default and lower market rentals.

35. Geographically, the investment property portfolio is inevitably concentrated within the city, which thus concentrates the economic risk in one area. We begin 2023 in the midst of a second economic contraction in three years, with high inflation and rising interest rates putting downward pressure on growth, creating a challenging environment for property. Higher debt costs are expected to result in lower investment volumes. Though investment volume has been low, prime commercial property yields are currently ranging from 4-4.5% in central London to 8-9.00% in the regions. In-house investment property generated 4.33% yield net of costs (excluding capital growth) in 2021/22 and annual valuations are currently being undertaken.

36. In its Q3 2022 UK Commercial Property Survey, the RICS reports an aggregate net balance of -10% for tenant demand, a significant deterioration from the +17% in the Q2 survey and +32% in Q1. Occupier demand fell for both retail and office space, with balances of -37% and -22% respectively. Overall, the commercial market remains characterised by a dearth of the quality supply that occupiers now require in sectors such as offices (key city centres), last mile delivery and distribution warehousing.

37. Commercial property investment purchases in Q4 2022 (excluding student housing) totalled £6.885 billion in Q4 2022, 38% down quarter on quarter, 68% year on year and 47% below the five-year quarterly average. This brings the rolling annual total to £50.4 billion which, thanks to a strong first quarter of 2022, is just 8% below the five-year quarterly average.

38. The industrial and office remained the most invested-in sectors, although the office sector recorded the sharpest decline quarter on quarter in Q4 of -69%.

39. Currently, the property investment portfolio is heavily fragmented due to its historical incremental build-up with a concentration in alternative assets (largely car parks) which generates 24.47% of total income, with offices generating 28% (albeit 34% of this is a single tenant at City Hall), retail generating 20%, industrial generating 8% and residential generating 13%. The car park assets, which provide a steady income stream, offer value added opportunities through potential change of use and redevelopment over time.

40. A budget of £93m is included in the Capital Programme for strategic investments and acquisitions that will support the Council’s regeneration aims and generate additional revenue income. Schemes funded by this will go ahead only if they meet the Council’s strategic aims and are considered a sound and prudent investment after full due diligence.

41. The Council is focused on delivering best returns from the portfolio and acquiring new assets and redeveloping existing assets will help to achieve this. The property investment strategy is focused around three elements:

- **driving income from the current portfolio** - the aim is to increase the portfolio by 2% per annum in net income terms (excluding new acquisitions). This will be achieved through a proactive asset strategy, enabling long-term deals to be agreed that benefit income outside regular lease events, as well as maximising increases from regular rent reviews;

- **streamline and future proof the current portfolio** - this will involve reviewing poorer performing assets and considering disposal (where there is no broader justification for holding them) and a long-term strategy for car parks. In addition, there will be investment into the portfolio where there are opportunities to generate further income;

- **invest in new commercial properties within Westminster** - general principles for investment are detailed below. All investment proposals will be reviewed on a case by case basis in the acquisition process, so not all the principles will need to be achieved for an investment to be made:

    - investment should primarily be focused on strategic fit and focused on the Council's long-term regeneration and economic objectives;
    - investments should consider possible diversification of the portfolio, with a meaningful and valid interpretation of what that means post-Covid for the market;
    - all assets acquired must be within Borough unless strategic opportunities arise with regard to adjacent, out-of-borough holdings;
    - new investments should consider yields of 4-5% over the short to medium term, and;
    - investment assets should not be acquired primarily for the purpose of generating yield (see para 57).

LONG-TERM INVESTMENTS

42. Prior to 2004, Councils were only permitted to make loans to, or invest in, other local authorities, the Government, banks or building societies. The introduction of the Prudential Code relaxed these restrictions and gave local authorities the flexibility to invest in more innovative methods of service delivery and income generation by:

    - establishing, controlling and participating in limited companies trading for a commercial return, and;
    - entering into loans and investments with "non-specified" counterparties, including limited companies and not-for-profit organisations.

43. These are classed as non-specified investments under DLUHC statutory guidance for local government investments.

44. No general legal restrictions are placed on the value, length or nature of such investments and the only proviso is that investments are placed in accordance with investment strategies formally approved by members. The Council's TMSS expressly permits new investments in non-specified institutions, subject to the new ruling that investment assets must not be transacted primarily for yield. For all transactions, specific proposals will be considered by the Tri-Borough Director of

Treasury and Pensions and approved by the S151 Officer, subject to due diligence and compliance with all rules and regulations.

45. Non-specified investments include asset vehicles, such as infrastructure and housing, which offer additional possibilities. Such assets can contribute to corporate priorities and improve service delivery. They also provide portfolio diversification and can offer more flexibility in terms of length of investment and timing of drawdowns.

46. Such investment is becoming more common in local government with authorities investing in projects to increase low cost and affordable housing, improve transport infrastructure, and support sustainable energy programmes as well as pooled property or equity investments, venture capital funds to support new and growing businesses, bond issues and unit trusts.

47. Such investments typically offer a higher risk adjusted return. However, they also tend to carry more complex risk profiles and attract higher transaction/due diligence costs and are unlikely to have a published unit price or credit rating. The onus therefore falls on the Council to make its own evaluation (with consultant support) of the investment and before any decision to proceed.

48. The Council's current portfolio of non-specified investments is:

	Value at 31 December 2022 £ million	Value at 31 March 2022 £ million	Expected return
Loans and Equity Holdings set up to meet strategic service and policy initiatives	£38.5	£55.9	Average yield of 5%. Profits are expected to be reinvested.
Property Fund Partnership (Real Lettings Fund)	£28.5	£27.7	Annualised 6% over seven-year life of fund
LGA long term loan	£19.0	£20.0	3.13%
Total	**£86.0**	**£103.6**	

49. By increasing its holdings in this area, the Council could reduce its reliance on the banking sector and facilitate the move towards a more long-term investment profile, as discussed below.

50. Identifying and investigating individual investment opportunities across multiple markets can be both time consuming and expensive. Such opportunities will be fewer as a result of the new PELB rules concerning investment primarily for yield.

LIABILITIES AND CASHFLOW NEEDS

51. To assess appropriate changes to the treasury portfolio, it is important to consider also the Council's liabilities and cashflow needs over time. This is imperative as the purpose of investment of assets is to better match upcoming cashflow needs, and to minimise funding gaps.

52. The Council has a significant capital programme that totals £2.740bn to 2036/37. This will be funded from £1.363bn of income, leaving a net funding requirement of £1.377bn. Thus, the need to take liquidity into account, to avoid unnecessary borrowing, is extremely important.

INVESTMENT ALLOCATION

53. The Council's investment portfolio is currently allocated between liquid cash based short-term investments, longer-term cash investments for the intention of generating enhanced yield and commercial property, pension investments and equity shareholdings which tend to be held for perpetuity or at least 20 years or more.

54. Achieving liquidity and the necessary cashflow to manage revenue and capital commitments does require a reasonable allocation of short-term investments, with over 95% of the cash portfolio maturing within 12 months regarded as reasonable.

55. Therefore, the proposed approach going forward is to move investment allocations towards proposals in Table 60, facilitating liquidity in an achievable manner:

INVESTING PRIMARILY FOR YIELD

56. Under the Public Work Loans Board (PWLB) framework, the Council will need to submit its three-year capital plan to the PWLB and classify under different areas of spend, as listed below, with classification the responsibility of the S151 officer. Any monies lent by the PWLB would also need to be classified under the following areas of spend:

- Service spending
- Housing
- Regeneration
- Preventative action
- Treasury Management: refinancing and externalisation of internal borrowing

57. Under the PWLB criteria, it is stipulated: "Local authorities must not pursue a deliberate strategy of using private borrowing or internal borrowing to support investment in an asset that the PWLB would not support and then refinancing or externalising this with a PWLB loan."

58. On transacting a PWLB loan, the S151 officer is required to confirm that the local authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield. When applying for a new PWLB loan, the Council will be asked to confirm that the latest plans submitted remain current and the assurance that they do not intend to buy investment assets primarily for yield remains valid.

59. The PWLB guidance defines investment assets bought primarily for yield as:

- buying land or existing buildings to let out at market rate;

- buying land or buildings which were previously operated on a commercial basis, which is then continued by the local authority without any additional investment or modification, and;

- buying land or existing buildings, other than housing, which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger, such as the completion of land assembly.

INVESTMENT ALLOCATION TARGETS

60. The following investment allocation targets are in place.

Type of investment	Allocation
Short-term investments – under six months	33 to 37%
Short-term investments – over six months less than one year	4 to 6%
Short-term investments – > one year < two years	5 to 7%
Short-term investments – > two years < three years	1 to 2%
Short-term investments – > three years < four years	1 to 2%
Short-term investments – > four years < five years	2 to 3%
Property	42 to 48%
Alternative investments	3 to 4%
Total	**100%**

FACTORS IN INCREASING YIELD

61. This has been partially achieved with the following ambitions set out in the TMSS. However, the requirement for security of capital and liquidity will remain paramount.

Change	Current situation	Risk	Progress made in 2022/23
Treasury Management			
Recent CPI inflationary pressures have led to a bank rate increase to 3.5% in December 2022, with further rises expected in the first six months of 2023.	Financial institutions are now offering favourable rates versus recent pricing, which the Council has been able to capitalise on.	There must be a balance struck which leaves adequate liquidity for the Council and an optimal amount of cash placed on deposit: too much cash invested early may not enable officers to take early advantage of future interest rate rises in 2023.	The Treasury operation is now improving the portfolio with higher rates as existing deals mature and new deals are transacted.
Investment property			
Adopt a more focused property investment strategy by reducing the number of properties and increasing the lot size to increase efficiency and reduce the cost of management and maintenance. A key objective is the acquisition of suitable properties which will assist in the unlocking or enhancement of regeneration schemes, or the achievement of other strategic benefits	Increased net return target of 4-5%	Adverse property markets may result in a fall in sale values.	There were two significant purchases completed in 2022. With a total outlay of c. £25m (including costs). The current market conditions are likely to create further opportunities during 2023 as organisations struggle with rising costs.

Change	Current situation	Risk	Progress made in 2022/23
(not necessarily financial) for the Council. Given the added illiquidity of property investment, this makes sense only if properties meet the strategic aims of the Council and can achieve higher yields than the Treasury portfolio and meet other objectives, such as reducing risk (e.g., CPI inflation) or helping meet statutory duties. Therefore, new acquisitions should be driven by strategic objectives and target a return of around 4-5%.			
Expanding the use of fund structures to deliver specialist functions such as supported living housing, homeless shelters, asylum housing, etc. This would meet statutory duties and generate a return.	Yields from public social housing real estate investment trusts (REITs), such as the Real Lettings Fund, in which the Council is currently invested, are generating returns of 6%. CCLA is an established provider of a property fund for local authority treasury investment.	By using a pooled fund structure, this arms-length approach distances the Council from the costs of directly managing such property and investment is secured on the underlying properties within the pooled structure.	During implementation, consideration will be given to additional transaction costs (which may be bid/offer on entry and exit), as well as high management fees and/or the underlying costs of such investments.
Alternative assets			
These fall outside traditional investments, such as listed equities and bonds, and include renewable energy pooled funds, infrastructure and commodities.	The TMSS includes various non-cash options in the schedule of investments that are permissible.	Permanent loss of capital and/or poor investment performance.	These transactions have traditionally been considered too high risk for the treasury portfolio. However, allowable options open to the Council in the TMSS include various fixed income funds. Pooled property funds as a potential investable asset are allowed in the TMSS.
Pension Fund			
Pension Fund to maintain surplus as reported in the 2022 Actuarial Valuation to remain fully funded in	An interim fund valuation will be carried out as a comparator in March 2023 to give a notional funding level.	Continuation of volatile financial markets in UK and abroad.	The Council paid off its own employer deficit during 2022, with a final payment of £80m now made. The 31 March

Change	Current situation	Risk	Progress made in 2022/23
the medium to long term.			2022 funding level for Westminster City Council (as a single employer) stands at 111%, improving from 86% previously in the 2019 valuation.

SCRUTINY

62. The Investment Executive meets to discuss monitoring reports on a regular basis. The Executive contains both Council Members and Officers.

OVERALL INVESTMENT TARGET

63. The overarching objective of this framework is to move towards increasing income generated from Council investments aspiring to go some way to matching inflation over the medium term, while maintaining adequate liquid cash balances for operational purposes and not exposing the capital value of investments to unnecessary risk.

GOVERNANCE

64. Innovation within the financial services industry leads to a constantly changing market and the availability of new asset classes, products and financial instruments. The Council needs to be able to operate more flexibly, and make decisions more quickly, to benefit from the opportunities presented by this environment and to successfully implement the changes outlined above. As highlighted in the table at para 57, there are non-cash investments options as an alternative investment for the Council's treasury cash, subject to further due diligence and formal approval.

65. The implementation, management and reporting of this Integrated Investments Framework will be approved by Full Council with specific investment decisions that require such action being delegated to the Cabinet Member for Finance and Council Reform, after due diligence and advice from the Executive Director of Finance and Resources and the Tri-Borough Director of Treasury and Pensions.

66. Day-to-day aspects of treasury management function will continue to be delegated to officers in the same way that they are at present, but the Integrated Investment Framework will:

- enhance the effectiveness of decision making;
- embed a good risk culture that encompasses appropriate due diligence, option appraisal and an atmosphere of openness;
- ensure that a holistic approach is taken towards managing the Council's portfolio.

67. The implementation, monitoring and reporting will continue to be delegated to the Investment Executive. The Investment Executive will comprise:

- the Cabinet Member for Finance and Council Reform and the Chairman of the Audit and Performance Committee;

- the Executive Director of Finance and Resources, Tri-Borough Director of Treasury and Pensions, and the Director Property and Strategic Asset Management;
- the Chief Executive and the Executive Director GPH as necessary.

68. Key information will be reported to Members through the investment reports. There is also a weekly treasury monitoring report sent to the Section 151 officer and other senior finance officers.

69. Given the complexity of this important area, the Council will need to rely on independent experts and advisors. The Council currently engages two investment advisors who:

    - provide advice on the current investment market and recommend new products in which to invest, and;
    - benchmark the Council's performance and identify any areas where there is scope for improvement.

DUE DILIGENCE

70. Due diligence is any process undertaken to:

    - investigate a business or person prior to signing a contract;
    - record the reasons behind an investment decision, and;
    - demonstrate that the Council is acting responsibly and has adequately assessed the balance between risk and reward.

71. Due diligence should be undertaken on all investments in a consistent manner, albeit proportionate, in terms of the value and complexity of the financial instruments being considered, and their relative impact on the Council's finances.

72. For a simple instrument such as a corporate bond, for example, a few paragraphs summarising risks and expected rewards, together with analysis from an advisor would suffice. A more complex product might require specialist assistance, comprehensive risk analysis and work undertaken to monitor and re-assess risks and performance regularly.

73. The Council has developed a framework for undertaking due diligence which promotes consistency and rigour whilst, at the same time, allowing for flexibility and a proportionate approach. It is based around the "6 Ps" principle as set out in Appendix A.

74. Whilst this framework does not rule out in principle any specific type of investment, all proposals will be considered in terms of:

    - reputational risk to the Council, and;
    - environmental, social, ethical and sustainability considerations.

OPTION APPRAISAL

75. An important aspect of due diligence is assessing the value for money offered by a new investment. Option appraisal will be undertaken for all new investments as part

of the due diligence process, on a proportionate basis that reflects investment value, expected duration, and anticipated level of risk. It will be:

- strategic outcome focused;
- structured around the key questions set out in Appendix B, and;
- take non-financial benefits into consideration where relevant.

76. Option appraisal should focus on the opportunity costs of the investment and a comparison against returns offered by other products or opportunities realistically available, rather than achievement of a “theoretical” rate of return.

FINANCIAL AND LEGAL IMPLICATIONS

77. This report identifies the potential for improved returns, aspiring to going some way to matching CPI inflation over the medium term. Approval and implementation will result in an integrated framework for managing the Council’s investment portfolio which supports improved returns and a more effective contribution to Council priorities and services.

BACKGROUND PAPERS

Council

2022/23 Treasury Management Strategy

2021/22 Statement of Accounts

Savills State of the Market Report

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

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APPENDIX A – DUE DILIGENCE FRAMEWORK

1. The Council has developed a framework for undertaking due diligence which promotes consistency and rigour whilst at the same time allowing for flexibility and a proportionate approach. It is based around the "6 Ps" principle as set out below:

Powers

a) What legal powers is the Council relying on to make the investment being proposed;

b) Has legality been considered in terms of the underlying nature of the activity, as well as the instrument or vehicle itself?

c) Have capital financing and MRP requirements been considered?

Permission

2. Does the Council need permission from the Secretary of State or anyone else before progressing this investment e.g.,

a) Members – and if so who (committee with delegated authority, cabinet or full Council)

b) Chief Officer if delegated decision-making powers apply

c) Consultation with the public or staff may be a legal requirement

d) Does the proposal involve legal negotiations with a contractor or 3rd party?

Policy

a) Does the proposal fit within the Council's policy objectives in terms of what it is trying to achieve?

b) If not does the proposal need to go to Full Council for approval?

Payment

a) How is the proposal to be funded both in terms of initial and ongoing costs (i.e. is there a budget – revenue and capital)

Procurement

a) Has the proposal been subject to the Council's procurement procedures?

b) Does it need to go through formal tendering or does it need a waiver?

c) Are there any State Aid or EU implications?

Press

a) Might the Council be exposing itself to criticism?

3. Whilst not all of the above considerations will apply to every investment scenario, this framework will be applied in principle to every investment proposal, with results reported to Members for consideration.

APPENDIX B – OPTION APPRAISAL

1. Option appraisal should be structured around the following questions:

Key questions	Issues to consider
How is the proposal to be funded in terms of initial and ongoing costs?	Is there an existing budget or is virement required? Does the proposal provide any added value to the Council in terms of improved efficiency, budget savings or reduced costs?
What is the opportunity cost of using up these cash resources?	What is the expected length of the investment period? What additional costs are there (transaction costs, due diligence etc.) in addition to the capital investment itself? Does the expenditure count as a capital transaction under capital accounting regulations? If so what are MRP/CFR implications?* Is there an exit strategy? Will this involve additional costs? Is there a risk of permanent impairment in the capital value of the investment?
Does the proposal link to corporate objectives and statutory services?	If so how does it compare to the cost of achieving similar outcomes? Will this delivery option increase or decrease outcome or cost risk?
Is the proposal solely to generate income?	What key assumptions and sensitivities are contained in the financial model? * What are best, worst and medium case scenarios? How do these compare to other investment opportunities within the same investment allocation?
What transaction, professional and management costs need to be considered?	Consider for example: Independent advice and "experts" Legal fees/stamp duty Tax, audit, accountancy, secretarial Officer time in attending meetings etc.

* To promote consistency when evaluating potential investments, any MRP set aside requirements for property or alternative investments will be calculated using the annuity method rather than on a straight-line basis.

APPENDIX C - Prime yields for commercial property

	November 2021		October 2022		November 2022	
West End offices	3.25%		3.75%		3.75%	
City offices	3.75%		4.25%	↑	4.25%	↑
South East offices	5.50%	↓	6.00%	↑	6.00%	↑
Provincial offices	4.75%		5.50%	↑	5.75%	↑
High street retail	6.50%		6.50%	↑	6.50%	
Shopping centres	7.50%	↓	8.00%	↑	8.00%	↑
Retail warehouse (Open A1)	5.50%		5.75%	↑	5.75%	
Retail warehouse (Restricted)	5.75%		6.00%	↑	6.00%	
Foodstores (OMR)	4.50%		5.50%		5.25%	
Industrial/Distribution (OMR)	3.25%		5.00%	↑	5.00%	
Industrial multi-lets	3.25%	↓	5.00%	↑	5.00%	
Leisure parks	7.50%		7.50%	↑	7.50%	↑
London leased (core) hotels	3.50%		4.75%		4.75%	
Regional pubs (RPI)	5.25%		5.75%		5.75%	

Source: Savills Research