**APPENDIX H**

**Briefing Note on CCLA Investment Options**

**Recommendation:**

That the Executive RECOMMEND to Council:

1. That the total sum of £1,500,000 from the Council's treasury management funds is invested in CCLA's (CCLA Investment Management Limited's) Local Authorities Property Fund (LAPF) and its Diversified Income Fund (DIF) as detailed in section 4.1 of this Appendix H.

## 1.0 Executive Summary

1.1 This report sets out the rationale for the recommendation of investing £1m into the CCLA DIF and £0.5m into the CCLA LAPF.

1.2 Combined, these investments could generate an additional £51k pa in additional investment income, based on current interest rates. In the first year the entry costs to the fund would need to be absorbed so this benefit won't start be realised until the second year e.g. 2019/20 onwards.

## 2.0 Background

**CCLA – Investment Services for Churches, Charities & Local Authorities**

2.1. A variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Council to invest, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Council to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Council's policy in the past, therefore, has been not to invest in these slightly more risky and less liquid forms of investment.

2.2. However, a variety of factors suggest that now may be an appropriate time to reconsider that approach, e.g.:

(a) The perception of increased risk in bank deposits.

(b) A growing UK economy that could support a more positive outlook for other forms of investment.

(c) A challenging budget outlook that would benefit from the influx of additional investment income.

2.3. Officers have therefore considered a variety of different forms of investment and have concluded that investment in to CCLA represents a balanced investment opportunity, splitting investment in to CCLA's two funds – the LAPF, which invests in UK Property and the DIF, which invests in global distributed investments. The latter pays dividends earned from revenue income generated from cash, AAA or BBB short-dated bonds and diverse investments in things such as energy / renewables, aircraft leasing, student accommodation, care homes, and some property.

2.4. **LAPF**

The CCLA (Churches, Charities and Local Authorities) Local Authority Property Fund has been specifically set up for local authorities, and currently has investments of over £933 million, with over 166 local authority investors including 9 county councils, 7 metropolitan councils/London boroughs and over 40 unitary and district councils. Devon County Council, Plymouth City Council, West Devon Borough Council and four Devon town councils are invested in the Fund. The fund own and operate 62 commercial properties across the UK, across various sectors with many having blue-chip tenants. By investing in this fund, South Hams would be able to diversify is risk exposure across the UK and multiple property types and sectors, generating a yield significantly higher than that generated by current treasury management investments, which averaged around 0.6% in the past 12 months.

2.5. The income yield over the course of the investment is likely be around 4-5%, significantly above the rates available for term deposits with banks. The income yield will vary from year to year, but tends to be within a fairly narrow range – the 12 months to Dec 2017 averaged a net income (after management costs) of 4.58%. A £500k investment would have the potential to yield £21k additional investment income in its first full year to help offset the budget pressures facing the Council.

2.6. However, there are risks that should not be discounted. The capital value of property can go down as well as up, and therefore the capital redeemed at the end of the investment could be less than the sum initially invested. There are also charges that would need to be met; there is a bid offer spread of 8.3%, so the initial value of the fund will be lower than the initial amount invested. The management charge is 0.65% of income generated per year, but dividends are paid after this has been deducted. These factors combined mean that any investment needs to be a minimum of 5 years, and capital growth would need to be around 2% per year to ensure that the capital redeemed at the end of the investment was at least equal to the initial amount invested. The investment can be redeemed at any time, but it may take 3 to 4 months from the time that the redemption request was made for CCLA to liquidate sufficient holdings in order to return the funds. If the Council only invested £500k, in normal market conditions it is likely that this could be returned to the Council within one month of the request.

2.7 It should be noted that the charges above are similar to those that the Council would incur if it were to buy residential property. Stamp duty on an investment property is 5%, whilst agents fees on disposal, legal fees on acquisition and disposal and ongoing management fees for the property would equate (or even exceed) the above costs. The management charge of 0.65% is lower than most typical investment bonds / pension funds, which typically charge 0.75% as an annual fee.

2.8. Appendix A shows a CCLA LAPF Fact Sheet. Further details about CCLA can be found at www.ccla.co.uk Investments into this fund do not count as capital expenditure and dividends are treated as revenue income. The Council could invest and then sell at a later date and this means not only does the Council obtain regular returns (Paid quarterly), it also has the potential to benefit from an increase in "capital" value.

2.9. The potential return of 4.58% is approximately 7.6 times higher than the forecast treasury management return. In 2017/18, the average current return achieved was approx. 0.6%.

2.10 **DIF**

The DIF is a newer fund and is available to a wider pool of investors (whereas the LAPF is only available to Local Authorities). It was launched in late 2016 and so far has £74m in managed funds. There are 10 Local Authority investors, including one county and four boroughs / districts. The minimum investment is £1m and on average the fund has generated a dividend yield, after management costs of 3%.

2.11 The lower return is due to the inherent lower risk appetite of the fund, with strict rules in place to ensure that at any time ,the maximum exposure to equities is 40%. Due to the nature of the investors, Churches, Charities & Local Authorities, all investments are closely scrutinised to ensure no investor would be embarrassed by inappropriate acquisitions or investments. The fund place a significant proportion of its managed funds in short dated bonds and cash instruments, meaning that withdrawals from the scheme are more liquid than the LAPF fund. With this in mind, the bid/offer spread is far lower, at 0.44%.

2.12 Like the LAPF, the scheme accepts revenue investments and on exit, revenue will be returned to the local authority. All dividends are paid as revenue income. This is one of the fundamental reasons why the CCLA investment is being proposed, and why CCLA is popular with Local Authorities as an investment opportunity.

2.13 A minimum £1m investment would generate annual returns of c£30k based on the current 3% yield, after the initial cost of acquisition. Appendix B shows a CCLA DIF Brochure. Further details about CCLA can be found at www.ccla.co.uk

2.14 In 2017/18 the average return on investments was 0.6%.The DIF yield of 3% is 5 times higher.

3.0 **Options available and consideration of risk**

3.1. Members could opt to follow the recommendation or invest a higher or lower sum. Alternatively, Members could opt to pursue an alternative investment strategy. Investment into the LAPF should only be considered if the investment can be maintained for a medium – long term, i.e. 5 years minimum. If the investment needs to be liquidated before that timeframe, it is highly possible that the sum returned would be less than the sum originally invested.

3.2. The DIF is not subject to the same bid/offer spread and therefore is more liquid as the LAPF and therefore this investment will be easier to liquidate if the Council choose to divest. Based on this difference and taking a balanced risk approach, it is recommended that Members agree to invest £1m into the DIF (averaging 3% dividend yield pa) and £0.5m into the LAPF (averaging a 4.58% dividend yield).Assuming dividend rates stay roughly stable, investing at these sums would generate an additional £51k pa for the Council.

3.3. The Council has for many years adopted a very cautious and prudent approach to treasury management. Lending has only been made to banks and building societies which have strong credit limits and meet the criteria set by the Council, using information published by the three major credit rating agencies. This policy has been maintained in the knowledge that putting security before liquidity or yield does impact on the income being generated from these investments.

3.4. Officers have consulted with two other local authorities who have already invested into the LAPF and one who has invested in the DIF. All suggested they were very happy to recommend investment.

3.5. The DIF itself is inherently more liquid than the LAPF as it reflects the underlying assets not being solely invested in property, there are established markets for equities and bonds.

3.6. In the Members' Budget Survey, 58% supported an investment, with 16% undecided.

**4.0 Proposed Way Forward**

4.1. It is proposed that if the Council approve this report's recommendations, officers invest the £500,000 into CCLA LAPF and £1m into CCLA DIF after 1 April 2018. These investments would be monitored as part of the treasury management function, but it is anticipated that the investment would be left to generate income for a minimum of five years. Balancing the investment across these two funds will help create a more diversified, risk managed fund for the Council in addition to the other funds it already manages.

**5.0 Implications**

| Implications | Relevant to proposals Y/N | Details and proposed measures to address |
|---|---|---|
| Legal/ Governance | Y | The Treasury Management Strategy Statement (TMSS) for 2018/19, set out the Council's investment priorities as being:<br>• Security of capital;<br>• Liquidity; and<br>• Yield. |

| | | |
|---|---|---|
| | | The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity.<br><br>In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.<br><br>The Treasury Management Strategy is risk averse with no investments allowed for a period of more than a year and very high credit rating are required together with a limit of £3m per counterparty. The TMSS has been updated accordingly for the recommended CCLA investments.<br><br>Agreeing to invest in the CCLA fund requires Council approval. |
| Financial | Y | An investment in to CCLA will represent an increased risk of loss of capital in comparison to the use of term deposits with banks and building societies.<br><br>Such an investment has the potential to provide a significant increase in investment income that could contribute towards the predicted budget gaps highlighted in the Medium Term Financial Strategy.<br><br>If there is a downward valuation in the CCLA investment in 2018/19, the decrease would be an expense to the Income and Expenditure Account of the Council, as the Available for Sale Reserve is not available in 18/19, due to a change in the Accounting Code of Practice. This could be significant, for example a 10% drop in the valuation of the £1.5 million investment at the year end would mean a charge to the Income and Expenditure Account of £150,000 in that year. Therefore this would affect the 'bottom line' of the Council adversely by £150,000. This is due to IFS9 as explained in Section 6 of the covering report. |

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|---|---|---|
| | | The converse is true - in that if the valuation increased, a gain would be realised in the Income and Expenditure Account. So the Council would see extra income in its Revenue Outturn for that year. |
| Risk | Y | The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect interest rate performance. The yield risk is regarding the volatility of interest rates/inflation.<br><br>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.<br><br>The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements.<br><br>See the risk of fluctuations in the valuation of the investment in the 'financial' section.<br><br>Investment interest income is reported quarterly to SLT and the Executive. |
| **Comprehensive Impact Assessment Implications** | | |
| Equality and Diversity | N | N/A |
| Safeguarding | N | N/A |
| Community Safety, Crime and Disorder | N | N/A |
| Health, Safety and Wellbeing | N | N/A |
| Other implications | N | N/A |

**<u>Supporting Information</u>**

**Appendices:**
Appendix I – CCLA LAPF Fund Fact Sheet
Appendix J – CCLA DIF Brochure