APPENDIX F

Briefing Note on CCLA Investment Options

Recommendation:

The views of the Joint Development Management Committee and the Overview and Scrutiny Panel are sought on :

1. Investing a further £2million from the Council's treasury management funds into the Local Authorities Property Fund (LAPF- investment of £1million) and its Diversified Income Fund (DIF – investment of £1 million).

1.0 Executive Summary

1.1 This report sets out the rationale for the recommendation of investing a further £2m into a combination of the CCLA DIF (£1m investment) and into the CCLA LAPF (£1m investment). The Council currently has £1m invested with the CCLA DIF and £0.5m with the CCLA LAPF.

1.2 Combined, these investments could generate an additional £60k 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. 2020/21 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 (prior to 18/19), therefore, has been not to invest in these slightly more risky and less liquid forms of investment.

2.2. However, a variety of factors have meant the Council has reviewed that approach, e.g.:

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

(b) A 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. In 2018/19 Members approved an investment of £0.5m into the LAPF and £1m into the DIF fund. Officers 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 £1,048 million, with over 234 local authority investors including county councils, 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 aswell as South Hams. The fund own and operate 71 commercial properties across the UK, across various sectors with many having blue-chip tenants. By further investing in this fund, SHDC would be able to further diversify its risk exposure across the UK and multiple property types and sectors, generating a yield (4.27% over last quarter) significantly higher than that generated by current treasury management investments, which averaged around 1%.

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.

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 Annual Management Charge is 0.65% of the net asset value of the Fund and is charged against income before any income distribution is made. These factors combined mean that any investment needs to be held for a minimum of 4 to 5 years ideally, and capital growth would need to be around 2% per year to ensure that the capital redeemed at the end of the investment is 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.

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 annual management charge of 0.65% is lower than most typical investment bonds / pension funds, which typically charge circa 0.75% as an annual fee.

2.8. Appendix G 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 further 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. **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 £76m in managed funds. There are 28 Local Authority investors.

2.10 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 further investment in the CCLA is being proposed, and why CCLA is popular with Local Authorities as an investment opportunity.

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

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. 4 to 5 years. 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 a further £1m into the DIF (averaging 3% dividend yield pa) and a further £1m into the LAPF (averaging a 4 to 5% dividend yield).Assuming dividend rates stay roughly stable, investing at these sums would generate an additional £60k pa for the Council.

3.3. 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.

3.4. In the Members' Budget Survey, 67% supported further investment in the CCLA.

4.0 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: • Security of capital; • Liquidity; and • Yield. The Council aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. 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. 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. Agreeing to invest in the CCLA fund requires Council approval.
Financial	Y	A further 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. 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.

		From 2023/24, if there is a downward valuation in the CCLA investment, the decrease would be an expense to the Income and Expenditure Account of the Council, as the Available for Sale Reserve is not available, due to a change in the Accounting Code of Practice. This could be significant, for example a 10% drop in the valuation of the £2 million investment at the year end would mean a charge to the Income and Expenditure Account of £200,000 in that year. Therefore this would affect the 'bottom line' of the Council adversely by £200,000 Up until 5 years time, fair value movements will not have an impact on the revenue 'bottom line', due to a Government statutory reversal.
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. 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. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements.
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

Supporting Information

Appendices:
Appendix G – CCLA LAPF Fund Fact Sheet
Appendix H – CCLA DIF Fact Sheet