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Leeds CITY COUNCIL

Report of Chief Officer Financial Services

Report to Corporate Governance and Audit Committee

Date: 22nd March 2019

Subject: Annual Treasury Management Governance Report

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for Call-In?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. This annual report provides assurance that the Treasury Management (TM) function is operating within its governance framework.

2. TM fully complies with the current CIPFA Code of Practice, the Prudential Code and the revised guidance notes for practitioners issued in 2013.

3. Since the last update all borrowings and investments undertaken have been in accordance with the approved governance framework.

4. TM operates within the governance framework and also uses additional market intelligence and information gathered from a variety of sources. These sources have been integral to protecting the authority from undue risk in the financial and money markets.

5. Internal Audit has provided substantial assurance on the control environment and compliance in their 2017/18 audit report.

6. Updates to the CIPFA codes and Department for Communities and Local Government (DCLG) guidance on Investments and Minimum Revenue Provision (MRP) occurred in December 2017 and January 2018. These updates were fully adopted for the financial year 2018/19 onwards as detailed in the report to Executive Board on 14th February 2019.

Recommendations

7. Note that Treasury Management continues to adhere to its governance framework including the CIPFA Code of Practice, the Prudential Codes 2011 and revised CIPFA guidance notes issued in 2013. All borrowing and investments undertaken have been compliant with the governance framework.

7.1 Note also that Treasury Management has ensured that it will fully complies with the updated CIPFA Code of Practice 2017 and the MHCLG investment and MRP Guidance for the financial year 2018/19 onwards.

1. Purpose of this report

1.1 This annual report outlines the governance framework for the management of the Council's TM function. This report also reviews compliance with updated CIPFA guidance notes for practitioners on the Prudential Code for Capital Finance in Local Authorities issued in 2018.

2 Background information

2.1 The operation of the TM function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities 2011 in particular: The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators.

- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least two times a year.

2.2 TM is responsible for managing the Housing Revenue Account and General Fund long term debt which is in the region of £2.09bn and investments that currently stand at around £46m. It also manages the cash flow requirements of the Council.

3 Main issues

3.1 The role of the Corporate Governance and Audit Committee is to ensure that TM is adhering to and operating within its governance framework, as shown in Appendix A.

3.2 During the year TM had continued to comply with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, Prudential Code (2011) and its guidance notes (2013). As such a strategy report was presented to Executive Board in February 2017 together with an update in November 2017. A further outturn report for the previous financial year was presented in June 2018. For the Year 2018/19 a strategy report was presented to Executive Board in February 2018 together with an update in November 2018.

3.3 During the year all borrowings and investments undertaken have been in accordance with the approved governance framework and are in line with the Treasury Management Policies and Practices.

3.4 In recent years the treasury strategy has taken advantage of the low short-term interest rates to fund its long term borrowing requirement. The Councils balance sheet strength has also been used to defray long term borrowing and avoid the risk associated with external Treasury Management investments.

3.5 The 2019 February Executive Board update report has highlighted that the current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. In November 2017 the Monetary Policy Committee (MPC) increased the bank rate for the first time in 8 years reversing the last cut made in August 2016. A further increase of 0.25% to 0.75% was made in August 2018 and further increases are expected going forward but expectations are that these increases will be introduced slowly and steadily. The strategy of deferring long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £648m by 31/03/2019. This exposure is considered manageable given historical capital programme slippage, the strength of the Council's balance sheet and the market for supplying short term funds remaining strong. These factors will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile.

3.6 The Council's current long term debt of £1.714bn has an average maturity of just over 39 years if all debts run to maturity. Approximately 13% of the Council's long term fixed debt has options for repayment which are the LOBO's excluding Barclays loans which are now fixed. In the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to just under 33 years. This compares favourably with the average maturity of the UK's government debt portfolio of just over 15 years. The existing profile of the Council's debt provides considerable certainty of funding costs with 62% or £1,298m of its total debt maturing in periods greater than 10 years.

3.7 The Lenders Option Borrowers Option loans (LOBO's) that many Local Authorities issued up to 2007/08 have been used successfully over the last 20 years to reduce the Councils interest costs in comparison to Public Works Loan Board (PWLB) funding available at the time. These loans also introduced short to medium term re-financing risk at a time when the average maturity of the Councils debt portfolio was becoming very long. In essence the standard LOBO's that the Council has issued are long dated loans, which after an initial fixed period, contain an option whereby the lender only can vary the rate of interest on the loan, but only at specific intervals. These periods are every 3, 5 or 6 years depending on the specific loan. If the lender exercises the option the Council then has the option to accept the change or to repay the loan without any penalty cost and repay the principal in full. No options have been exercised since 2008 and in the current economic climate these loans are essentially fixed.

3.8 After the end of the year the Council, like many others received a challenge to its Statement of Accounts for 2016/17 on the basis that "the decision to sign up to so many (46) LOBO loans was unreasonable and irrational". This has been resolved by the external auditor who resolved that the challenge was not sustainable and that the Council had acted reasonably.

3.9 The Council has £215m of LOBO loans with Barclays of which £110m are the subject of a class action initiated by a total of 7 Councils. These LOBOs contained clauses that referenced London Inter Bank Overnight Rate (LIBOR) at a time when Barclays were subsequently convicted and fined for fraudulently fixing LIBOR. This is an ongoing action and further details will be reported as appropriate as the action progresses.

3.10 The Council's total external borrowing Capital Financing Requirement CFR i.e. the amount required to fund previous and current capital expenditure is circa £2.2bn and its assets are valued at £5.4bn as at 31 March 2018. The setting and

monitoring of the capital programme seeks to ensure that we invest and maintain our assets whilst supporting the best council plan priorities. Treasury Management strategy determines the revenue affordability of the programme.

3.11 To mitigate against the exposure to rising interest rates the Council continues to explore forward funding options which will give the Council the ability to lock in future funding at near current rates.

3.12 TM continues to review key aspects of the framework including prudential indicators to ensure that they continue to be fit for purpose and provide the right evidence that TM is operating within acceptable levels of risk. The strategy updates to Executive Board include an update on prudential indicators. TM is complying with all of CIPFA's prudential indicators as shown at Appendix B which was reported to Executive Board on 14th February 2019.

3.13 The operation of TM within its governance framework is also complemented by additional market intelligence and information gathered from a variety of sources. These tools involve:

- The use of real time market information on the financial and money markets in the UK, Europe, US and other major economies;
- Discussions with market participants and brokers;
- Use of treasury advisors to test market views;
- Networking and sharing of information with Core Cities and West Yorkshire districts;
- Attending market seminars providing technical and economic updates;
- Daily market updates from financial institutions and brokers;
- Thorough review of new financial products and how they fit within the governance structure; and
- Undertaking continuing professional development and ensuring that appropriate training is undertaken.

3.14 Furthermore TM undertakes to respond to all treasury management consultations and influence the national governance framework, through attendance at regular core city meetings.

3.15 Internal Audit has completed its annual review of the TM function for the year 2017/18 which is the most recent audit review. This involved a risk based system audit of TM to evaluate and validate key systems controls.

Treasury Management & Bankline 2017/18

Key controls for a sample of investments, loans and interest payments for 2017/18 were reviewed. The Internal Audit report issued 10th May 2018 provided the highest level of assurance for the control environment and compliance with the control environment.

3.16 CIPFA and the Department for Communities and Local Government issued revised codes and guidance in December 2017 and January 2018 on the following areas related to Treasury Management:-

- The Prudential Code - for Capital Finance in Local Authorities 2017 (CIPFA)
- Treasury Management in the Public Services - Code of Practice 2017 (CIPFA)

- Local Authorities Investment Guidance 2018 (DCLG)
- Minimum Revenue Provision Guidance 2017(DCLG) – adopted annuity method0

These codes and guidance have been fully adopted by the Council for the financial year 2018/19 in the strategy report submitted to Executive Board on 14th February 2019. These were not adopted for the start of the year 2018/19 due to the timing of their issuance and the codes accepted that implementation for the year 2018/19 during the year was acceptable. The following changes have been implemented as part of the change to the codes and guidance:-

- Requirement to determine a Capital Strategy and is included as an appendix to the Capital report and is attached at Appendix C.
- Prudential Indicators 1 and 2 have been expanded to show the financing costs for both General Fund and HRA as a percentage of the net revenue stream for external borrowing costs only and for borrowing cost and other long term liabilities (PFI and Finance leases)
- Gross debt and Capital Financing requirement has been changed from Net debt.
- Estimate of the Incremental Impact of new capital investment on General Fund has been removed this was formerly Appendix B Prudential Indicator 3
- Estimate of the Incremental Impact of new capital investment on Housing revenue Account has been removed this was formerly Appendix B Prudential Indicator 4
- The requirement to formally adopt the Prudential Code has been removed as it is implicit that all local authorities will comply and abide by the code. This was formerly Prudential Indicator 13.
- Prudential Indicator 14 in Appendix B, the upper limit for fixed interest rate exposures is no longer an explicit indictor under the guidance notes for practitioners however this is being retained.
- Prudential indicator 15 in Appendix B, the upper limit for Variable interest rate exposure fixed rate exposures is no longer an explicit indictor under the guidance notes for practitioners however this is being retained.
- Prudential indicator 18 in Appendix B, net debt as a percentage of gross debt is no longer an explicit indictor under the guidance notes for practitioners however this is being retained.
- New requirement to create and maintain a register of all counterparties with whom we have elected up to Professional status with under the Markets in Financial Instruments Directive II (MIFIDII). This is now included within the Treasury Management Policy Statement (TMPS)
- New requirement to report on all non-treasury management investments, loans, guarantees as well as commercial investment activity. This is included in the Capital and Investment strategy as an appendix to the Capital report and is attached at Appendix C.
- The MHCLG Guidance has been expanded and enhanced to cover the commercialism agenda and to bring non treasury management investments within the reporting envelope. It separates investments into :-
    - Specified Investments (mainly TM Investments)
    - Loans
    - Non Specified Investments
    - Non-financial investments
- MHCLG guidance also brings a new concept of proportionality in relation to income generated from commercial investments compared to a local authority's wider financial base.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 There has been no consultation in relation to this report

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 This report does not have any direct equality and diversity/cohesion and integration issues.

4.3 Council policies and Best Council Plan

4.3.1 The execution of the Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan.

4.4 Resources and value for money

4.4.1 The execution of the Treasury Strategy enables funds to be raised and managed in the most efficient manner in line with the approved strategy as presented to Executive Board on 7th February 2018 and 14th February 2019.

4.5 Legal Implications, Access to Information and Call In

4.5.1 The legislative framework which governs TM is outlined in section 2.1. This framework includes compliance with the CIPFA Treasury Management Code of Practice, the prudential code 2011 and revised guidance notes issued in 2013 as revised.

4.5.2 There are no legal or access to information issues arising from this report.

4.6 Risk Management

4.6.1 As set out in the Treasury Management Policy Statement, TM activities are carried out within a risk management framework and the management of risk is key to securing and managing the Council's borrowing, lending and cash flow activities.

4.6.2 By complying with and adopting the CIPFA Treasury Management Code of Practice, Prudential Code and guidance notes, assurance is given that arrangements are in place to manage risks effectively.

5 Conclusions

5.1 This report confirms that the treasury management governance framework is up to date and fit for purpose, that the Council is operating within its governance framework and as such is complying with the CIPFA Treasury Management Code of Practice, Prudential Code and updated guidance notes. A 2017/18 Internal Audit report gave TM substantial assurance on both control and compliance. It also confirms that the strategy is being monitored and reported back to Executive Board and full Council as appropriate.

6 Recommendations

6.2 Note that Treasury Management continues to adhere to its governance framework including the CIPFA Code of Practice, the Prudential Codes 2011 and revised

CIPFA guidance notes issued in 2013. All borrowing and investments undertaken have been compliant with the governance framework.

6.3 Note also that Treasury Management has ensured that it fully complies with the updated CIPFA Code of Practice 2017 and the MHCLG investment and MRP Guidance for the financial year 2018/19 onwards.

7 Background documents[1]

7.1 None

[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Appendix A

Treasury Management Governance Framework

FULL COUNCIL	EXECUTIVE BOARD	CORPORATE GOVERNANCE & AUDIT COMMITTEE	RESOURCES AND COUNCIL SERVICES SCRUTINY BOARD
Setting Borrowing limits	Treasury Management Strategy	Adequacy of Treasury Management policies and practices	Review / scrutinise any aspects of the Treasury management function
Changes to borrowing limits	Monitoring reports in year	Compliance with statutory guidance	
Treasury Management Policy	Performance of the treasury function		

↓DELEGATIONS TO OFFICERS

DELEGATION SCHEME	TO WHOM	FUNCTION DELEGATED
Officer delegation scheme (Executive Functions)	Chief Officer Financial Services	Making arrangements for the proper administration of the authority's financial affairs
Executive Functions Specific Delegations Page 24 (d) Treasury Management	To Chief Officer Financial Services	The provision of financial services, including treasury management (encompassing the making of payments and borrowing of loans)
Miscellaneous Functions - Financial Regulation 20: Treasury Management Page 32	Function delegated to Chief Officer (Financial Services)	To ensure that all investment and borrowing is valid, accurate, efficient, properly accounted for and in accordance with statutory and corporate requirements

↓OPERATIONAL AUTHORITY OF OFFICERS/CONTROL FRAMEWORK		
POLICY DOCUMENT	**TO WHOM**	**OPERATIONAL AUTHORITY**
Treasury Management Policy Statement (section 11) Policy on Delegation and Review Requirements and Reporting Arrangements	Chief Off. Financial Services Head of Finance - Technical Senior Treasury Manager Assistant Finance Manager	Implementation of decisions taken at Treasury strategy review meetings and day to day management of treasury operations
CIPFA: Code of Practice Prudential Code Guidance Notes	Head of Finance - Technical Senior Treasury Manager Assistant Finance Manager	Ensure compliance and that any changes are reflected in the operating framework.

Appendix B

Leeds City Council - Prudential Indicators 2017/18 - 2019/20

No.	PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note a)	10.19%	12.73%	11.70%
2	HRA	11.01%	11.07%	11.28%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note b)	10.97	40.77	63.06
4	increase in housing rent per week	0.00	0.01	0.20
5	Net Borrowing and the capital financing requirement (Note c)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	288,778	237,573	203,200
7	HRA	85,927	86,583	131,170
	TOTAL	374,705	324,156	334,370
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	2,030,097	2,109,480	2,184,901
9	HRA	815,077	811,611	832,844
	TOTAL	2,845,174	2,921,091	3,017,745
9a	**Limit of HRA Indebtedness as implemented under self financing**	721,327	721,327	721,327

No.	PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt**			
	borrowing	2,450,000	2,450,000	2,500,000
	other long term liabilities	740,000	720,000	690,000
	TOTAL	3,190,000	3,170,000	3,190,000
11	**Operational boundary**			
	borrowing	2,200,000	2,300,000	2,350,000
	other long term liabilities	720,000	700,000	670,000
	TOTAL	2,920,000	3,000,000	3,020,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days** (per maturity date)	150,000	150,000	150,000
18	**Net Debt as a percentage of Gross debt**	99.4%	99.4%	99.5%

16	**Maturity structure of fixed rate borrowing as at 31/03/2018**	**Lower Limit**	**Cumulative Upper Limit**	**Projected 31/03/2018**
	under 12 months	0%	15%	2.76%
	12 months and within 24 months	0%	20%	5.43%
	24 months and within 5 years	0%	35%	11.52%
	5 years and within 10 years	0%	40%	5.06%
	10 years and within 20 years			1.67%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	41.21%
	40 years and within 50 years			24.02%
	50 years and above			8.33%
				100%

Notes.

a **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

b **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

c **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

d **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

e **Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in Frebruary 2010, 2012 and 2017**

Appendix C

Capital and Investment Strategy

1. Introduction and Requirements

1.1 This report sets out the Council's Capital and Investment strategy. From 2018/19 there are new requirements for local authorities to have both a Capital Strategy and an Investment Strategy, with the option to produce one strategy document covering both of these areas. The council has opted to produce an overall Capital and Investment Strategy, given that there is a significant overlap between the two areas.

1.2 The requirement for a Capital Strategy is included in the revised Prudential Code for Capital Finance in Local Authorities 2017. The Prudential Code was developed by CIPFA (Chartered Institute of public Finance and Accountancy) as a professional Code to support Councils in taking their decisions. Councils are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local government Act 2003.

1.3 In financing capital expenditure Councils also have to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

1.4 The capital strategy sets out the principles that support the Councils 3 year capital programme and as such how it supports corporate priorities and objectives.

1.5 The requirement for councils to publish an annual Investment Strategy is included in the latest edition of the government's Statutory Guidance on Local Government Investments.

2. Objectives

2.1 The Capital Strategy sets the framework for all aspects of the Council's capital expenditure and capital investment decisions. It will support: strategic planning, asset management and proper option appraisal.

2.2 The capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

2.3 The keys aims of the strategy are to:

- To ensure that decisions are made within the framework, CIPFA codes and statutory legislation;
- Prioritise and deploy capital resources in line with corporate priorities;
- Support service plans;
- Address major infrastructure investment;
- Support the review of the Council's estate and provide investment to ensure that it is fit for purpose;
- Enable investment on a spend to save basis;
- Create sustainable income streams through capital investment;
- Support the revenue budget and assist in the delivery of budget decisions;
- Support economic growth and outcomes; and
- Attract investment in the City through third party, grants or private matched funding.

2.4 Capital investment decisions should be undertaken with regard to:

- Service objectives;
- Proper stewardship of assets;
- Value for money – through option appraisal;
- Prudence and sustainability;
- Affordability; and
- Practicality – achievability of the forward plan.

2.5 The Investment Strategy brings together information on all of the council's investment activities, covering its Treasury Management investments, other service related loans and investments and non-financial investment activity such as the acquisition of investment properties.

2.6 The aim of the strategy is to enhance transparency and accountability by presenting a clear picture of all of the council's investment activity, including the contribution made by investments to the council's objectives, the decision-making process for entering into investments, the exposure to risk, and the risk management arrangements in place.

3. Governance of the Capital Programme

3.1 The 3 year capital programme is established in February of each year together with the Treasury Management strategy and the revenue budget. Quarterly capital update reports are provided to Executive Board.

3.2 The affordability of the capital programme is considered within the Treasury Management report and the funding requirements are set within the revenue budget planning process and with the framework of the medium term financial strategy.

3.3 The Council has a process to ensure that effective decision making takes place that includes:

Democratic decision-making and political approval:

- The Council set the corporate priorities;
- The Council approves the Capital programme, the Treasury Management Strategy and the revenue budget together;
- The Council has an approved scheme of delegation to effect and support efficient decision making (See Annex XX);
- The scheme of delegation enables Executive Board to approve subsequent scheme injections and authority to spend and changes to the capital programme;
- Directors and the Council Chief Officer Financial Services also have delegated powers to inject and provide authority to spend on schemes;
- All schemes progress subject to the Council's constitution, scheme of consultation, financial regulations and procurement requirements;
- The Chief Officer Financial services will report on the affordability and sustainability and risk of capital investment decisions;
- Audit and Governance provide scrutiny on the treasury management framework; and

- The Chief Officer – Financial Service provide assurance on the sustainability and affordability of the Councils financial affairs

Officer Groups:

- Officers, through the Council's Asset Management Board (AMB), Strategic Investment Board (SIB) and Corporate Leadership Team (CLT) are able to influence any investment decision before political approval is sought at Cabinet and Executive Board;
- SIB has the overall responsibility for the strategic development of the capital programme.
- Directorate management teams consider the scheme business cases before submission to SIB and CLT
- Directorate teams manage the monthly forecast spend of their schemes
- Specific project boards are represented by appropriate skilled officers from within the Council and with external specialist engagement as appropriate;
- Monthly reporting of the capital programme to Directorates and the Council's Financial Reporting Group (FRG).
- Monthly reporting of the updated projection of treasury management cost of debt covering the reporting MTFP period is made to the FRG

4. Project Initiation

4.1 In previous years capital schemes could be injected at any point through the year with the cost of additional borrowing managed within treasury management. The strategy adopted for 2019/20 onwards has sought to ensure that the revenue impact of capital investment decisions are taken at the same time that the revenue budget is set for the following year.

4.2 Directorates now submit their capital programme proposals in advance of the new financial year. Scheme proposals must be underpinned by a clear business case with robust costings and projections of income, where appropriate, that will stand up to scrutiny. The Business case and report must be prepared in accordance with corporate guidelines.

4.3 These submissions are ranked in terms of:

- Priority 1 - essential health and safety, protecting revenue budgets and business critical/corporate priority;
- Priority 2 - departmental priority; and
- Priority 3 - further business case development required

4.4 In addition to the prioritisation of individual proposals and programmes the whole programme will be assessed for:

- Achievability – Does the Council have the resources and technical expertise to deliver within the timescales?
- Prudence & Affordability – To ensure that the revenue cost of debt remains affordable within the Medium Term Financial Plan;
- Non-monetary benefits – Social well-being, health and environmental benefits; and
- Impact upon the Council's 5% partial VAT calculation.

4.5 These new investment programmes are appraised in conjunction with a review of the priorities within the existing programme. This process allows for check and challenge

with peer review of scheme proposals before the overall affordability of the programme is considered. This review is overseen by the Council Strategic Investment Board, a report that receives themed investment proposals throughout the year.

4.6 In the appraisals of schemes the Council will make use of internal officer experience together with support as required from external professional advisors to ensure that investment decisions are robust and will stand up to subsequent scrutiny.

5. Project Monitoring

5.1 Where appropriate project boards are established comprising suitably experienced and qualified staff with relevant expertise to assist decision making. Board representation would normally consist of: the project sponsor, programme managers, finance, legal, property, support staff and if appropriate HR, communication and external specialist expertise.

5.2 Monitoring of individual schemes and programmes takes place on a monthly basis with financial status reports of actual spend against forecast reports prepared and reported to Directorates. A monthly summary position is taken to the Council's Financial Performance Group.

5.3 Quarterly monitoring reports are taken to the Council's Executive Board. These highlight actuals spend against forecast, progress on schemes, injections, deletions and the impact on future years.

5.4 As required by the CIPFA code of practice on Treasury Management the Council reports on the strategy for the forthcoming year before the start of the year (usually in February to Executive board and full Council. Additionally a half year update report is submitted to Executive board in November during the year with a final report on the previous year being submitted in June/July following the close of the financial year.

6. Capital and Capital Investment Priorities

6.1 The Council has a significant estate to maintain but is also undertaking and facilitating large scale infrastructure development that will underpin the Council's best plan objectives. It remains focused on delivering these ambitions but recognises the financial pressures that the Council is facing. The Council will continue to seek to secure funding for the major infrastructure needs of the city.

6.2 The Council's capital investment objectives are centred on the Council's best plan ambition to be a strong economy and a compassionate City. The priorities cover:

- Addressing housing inequalities;
- Health and wellbeing;
- Creating 21st century infrastructure;
- Creating a child friendly city;
- Having safe and strong communities;
- Ensuring inclusive growth; and
- Increasing the Cultural offer.

Housing

6.3 Significant investment in the Council's housing estate ensuring that it meets decency standards, fire safety compliance, improving health and affordable warmth, low carbon and energy efficiency including a District heating network

programme, improvements to the environment through reduced carbon emissions and supporting more people to live safely in their own homes.

6.4 New capital investment proposals will be prioritised according to the following, with works that contribute to legislative requirements, the health, safety or wellbeing of residents taking precedence over others:

- Top priority – legislative requirements, health, safety and wellbeing (e.g. fire safety, asbestos, DDA, heating and insulation, lifts, aids and adaptations etc.);
- High priority – structural works and key building components (e.g. structural remedials, concrete repairs, roofs, chimneys, pointing, damp proof courses, windows and doors etc.).
- Medium Priority – internal works and non-key building components (e.g. kitchens, bathrooms, internal communal areas in blocks etc.).
- Low priority – environmental and estate improvements (e.g. garages, fencing, paths etc.)

6.5 The Council is targeting council housing growth funding from within the overall programme to support the delivery of extra care housing. In addition the empty homes programme continues to bring empty homes back into use and is delivering Council owned extra care apartments with the intention that this investment acts as catalyst to promote the wider development of extra care across the city.

Health and Wellbeing

6.6 Demographic factors form a key element of the strategic context; people are living longer and with a higher level of needs. As a result of these increased demands the way care is delivered needs to change and there is a move towards more people being supported to live at home. There is a changing focus from providing help to helping people help themselves. In terms of capital investment needs the main issues are:

- Investment in opportunities for vulnerable adults to access universally provided services;
- Investment in changing analogue telecare to digital, equipment and adaptations to support people living at home; and
- Investment in appropriate technology and business systems to enable the personalisation and direct access by people to health and social care support leading to improved outcomes including adaptation to homes and assisted living initiatives.

6.7 In contrast there will be a significant reduction in directly provided residential and day care provision in response to reducing demands for these services. This move could release assets for disposal but there is also a need to ensure that the remaining facilities, required for more specialised and re-abling services, are fit for purpose. Initiatives include Health centre redevelopment and dementia intensive therapy unit.

6.8 Work continues with colleagues from the Health sector the city to bring forward schemes designed to fulfil requirements and £25m has been set aside to further develop initiatives at the local level.

Creating 21st century infrastructure

6.9 **Public Realm Strategy** - Engaging and quality public realm is critical to the continued success and robustness of the city centre; creating a welcoming city which has the wow factor.

6.10 **HS2/Southbank** – The Council is taking a lead with partners in delivering HS2 and Southbank infrastructure. The aim is to double the size of the city Centre.

6.11 **Major highways and bridge** works including LTP and developer contributions to address backlog maintenance on district roads/streets. The Leeds Public Transport Investment programme comprises a package of public transport improvements that, taken together, will deliver a major step change in the quality and effectiveness of our transport network. In addition the Council has made good progress in bringing forward the package of transport measures that will be essential to support the development of the East Leeds Extension strategic growth area. Central to these is the East Leeds Orbital Route.

6.12 **Essential Information and Technology Infrastructure –** There are a number of major essential IT investments and associated programmes of work that are required over the next few years. These include upgrades to Windows 10, continuing the rollout of the new collaboration and telephony, replacement of hundreds of old PC's and laptops, investment in a range of cyber security measures, refresh and future proofing our server and storage estate and provide services across the city, upgrade, replace or consolidate applications to be compliant with external Public Service Network (PSN) and General Data Protection Regulations (GDPR).

6.13 **Full Fibre Network Bids –** Commitment to full fibre connectivity to all schools, council flats and CCTV point from which fibre providers will expand their networks into localities. Depending on the outcome of the bid a more detailed report will come to Executive Board relating to the implementation of the scheme.

6.14 Major projects include enhancing flood alleviation resilience continuing to build a cycling network, establishing a **District Heating Networ**k, creating a compressed Natural Gas Station and the conversion of the Council's fleet to the latest emission standards including Conversion of Refuse collection vehicles to compressed gas. The Council is also introducing a congestion zone and will provide support to licenced taxis to convert to greener vehicles.

Children's Services

6.15 Demographic change also places a significant pressure on Children's Services in the need to provide additional primary school places to meet the demand resulting from rising birth rates. The focus is now moving the provision of secondary places. There is a significant funding gap that the Council will look to the government to fund but provide shortfall solutions through the use of CIL, provision of free schools and borrowing. In addition there are significant backlog maintenance requirements within the estate that will use **Capital Maintenance and Devolved Formula Capital** plus local resources.

Communities

6.16 The next phase of Community Hubs will allow the continued roll out of the Community Hubs with fully integrated services across the city including, asset rationalisation, co-location of housing back offices, essential backlog maintenance and new ICT infrastructure and equipment to enable new ways of working over the next 3 years.

6.17 The Local Centres Programme (LCP) through engagement with ward members, local businesses and communities create viable local centres that are accessible, safe, resilient and fit for the 21st century. The town heritage initiative will provide further investment key heritage assets in the City.

Growth

6.18 There are a number of initiatives aimed at supporting business growth in the city. These include: the Digital Business Incubator (Leeds Tech Hub) - The Leeds Tech Hub Fund was introduced as a catalyst for growth and expansion in the city's fast-growing digital sector; Workspace Development and Investment Fund - This fund is designed to support providers of affordable specialist space to small start-up business particularly in the creative and manufacturing sectors that have found difficulty in finding premises as the Leeds property market continues to boom; and Innovation District - This collaboration with Leeds Teaching Hospitals NHS Trust and the University of Leeds seeks to develop a Leeds Innovation District to the north of the city centre. Initial work has scoped out potential development sites. This fund will contribute to public realm and early stage development activities.

Culture

6.19 The Council will continue to support the Channel 4's relocation to Leeds and work with the creative and digital sectors and other to provide to expand the film and televisions talent and expertise within the region.

6.20 The Council continues to expand the cultural offer within the city and is providing together with the Arts Council and the Leeds Playhouse significant investment in the redevelopment of the Leeds Playhouse.

Other initiatives

6.21 There are a number of other significant initiatives that are based upon sustainable business plans:

- Rationalisation of the Council's estate;
- Reduction in backlog property maintenance;
- Measures to maintain income and reduce costs through spend to save business cases;
- Investment in sporting facilities;
- Invest in heritage assets on a sustainable basis; and
- Invest in initiatives that support the revenue budget

7. Capital Programme Priority and Corporate Links

7.1 The capital programme links into wider processes and plans across the Council and should not stand alone. In setting, monitoring and reviewing individual schemes/programmes and the overall capital programme consideration should be given to:

- Council best plan;
- Asset management plan;
- Medium term financial strategy;
- Treasury management strategy including prudential indicators; and
- Internal and External audit.

8. Revenue implications

8.1 The revenue implication of capital investment should be considered alongside revenue budgets. Capital investment decisions should consider:

- The costs of borrowing (interest and Minimum revenue provision);
- Future whole life asset planning including capital (future capital maintenance requirements and revenue implications (running costs and maintenance costs);
- Realisation of cashable and non-cashable benefits; and
- Impact upon the economy and the generation or support of Council tax and business rates.
- Proportionality

9. Funding Strategy

9.1 A range of options are available for the Council to fund its capital expenditure requirements. This capital investment must be in line with the CPFA Prudential Code for Capital Finance in Local Authorities. The level of borrowing that the Council undertakes must be within the code and its management is covered with in the Treasury management strategy.

9.2 The Council will seek to maximise external funding sources before it undertakes borrowing, whilst ensuring that borrowing remains affordable and within the medium term financial strategy.

9.3 The main sources of funding available are:

- Government grants;
- Match funding;
- City region funding including the LEP;
- European funding;
- Developer funding through CIL, S106 and S278 contributions;
- Private sector funding;
- Capital receipts; subject to funding repayment of existing debt, PFI liabilities etc.;
- Generation of income streams or the avoidance of costs though robust business case that pay for the costs of borrowing;
- Corporate borrowing where the funding is a bottom line revenue cost;
- Lease finance; and
- Revenue funding.

9.4 In addition the Council may also choose to grant fund capital expenditure to third parties or provide loans – covered in the investment strategy.

10. Risks

10.1 The risks associated with this strategy should be considered in the context of the Councils risk and governance reporting framework and the methods for monitoring and escalation.

11. Knowledge and Skills

11.1 The Capital and treasury management function is managed by a number of experienced and qualified staff. They all follow a continuous professional

development plan that forms part of the Council's appraisal process. The section is headed up by a CIPFA qualified accountant and reports to the S151 Officer who is also a CIPFA qualified accountant.

11.2 Individual capital schemes are undertaken by professional qualified staff in appropriate disciplines. External support and advice is also sought through a framework contract as and when required.

11.3 Members are consulted in early stages of project development and provide approval of schemes at Executive Board and full Council when the capital programme is set Members are provided with training on treasury and capital management.

12. Investment Strategy

12.1 The Council's investment activities cover three broad areas – treasury management investments, other financial investments such as loans and equity investments which are made to achieve service objectives, and non-financial investments such as in property.

12.2 Treasury management investments

12.2.1 The council makes investments on an ongoing basis as required for the purposes of efficient treasury management. The scale of these investments, the investment policy and the risk management approach are all covered in the Treasury Management Strategy which is published alongside this document.

12.3 Contributions made by non treasury financial investments

12.3.1 The statutory guidance requires councils to identify and disclose the range of contributions which its existing non treasury management investments make to its objectives.

12.3.2 The following table outlines the contributions made to service objectives made by the non treasury financial investments which the council held at 31st January 2019.

Investment	Investment Category	Value at 31st March 2018 £k	Cost of Acquisition £k	Nature of contribution made	Valuation Basis
Shareholding in Merrion House LLP	Equity	37,000	29,198	Efficient procurement of accommodation	Fair value
Leeds City Region Revolving Investment Fund LP	Equity	4,579	4,579	Promotion of economic development	Cost less provision
Loan to Leeds City Credit Union	Loan	1,190	1,190	Financial inclusion	Cost less provision
Assisted Homebuy Scheme (equity loans)	Loan	1,007	861	Access to affordable housing	Fair value
Equity loans to householders	Loan	360	360	Various including health and wellbeing, and low carborn.	Cost less provision
Council house mortgages	Loan	259	259	Access to affordable housing	Cost less provision
Loans to housing associations	Loan	176	176	Access to affordable housing	Cost less provision
Loans to Leeds Community Ventures Ltd	Loan	130	130	Efficient procurement of accommodation	Cost less provision
		44,701	36,753		

12.3.3 The table also identifies those loans and investments which are held at fair value and those which are held at cost less any appropriate provision for non-payment. It should be noted that the values shown are as at 31st March 2018 and that a change in accounting standards will require a change from 31st March 2019 in the method of evaluation of provisions for non-payment of loans to an "expected credit loss" basis. It

is not anticipated that there will be any significant changes to carrying values as a result of this.

12.4 **Investment priorities, decision making and risks for non-treasury financial investments**

12.4.1 As regards their treasury management investment policies, councils are required to prioritise security and liquidity, and to only consider the yield that can be obtained within appropriate levels of security and liquidity. However different priorities apply when considering non treasury investments. The council will only enter into financial investments which are outside of its treasury management activities where it is seeking to achieve a service objective. This means that the requirements to prioritise security and liquidity which would apply to treasury management investments do not carry the same level of weight in considering such investments. Further, whilst the council's non treasury financial investments do in some cases generate a return, any such yield is incidental to the reasons for entering into these loans and investments.

12.4.2 Prior to making loans or other financial investments, the council carries out a thorough financial evaluation and due diligence of the risk against the return, including the intended service outcome. In addition to expected cash flows, this will take into account any borrowing costs arising and, where investments fall within the definition of capital expenditure and are funded by borrowing, the requirement to fully fund the investment via the Minimum Revenue Provision over an appropriate number of years. A business case should be produced, to cover :

- Which Council objectives are being supported;
- Financial business case including sensitivity;
- Financial due diligence;
- Legal Powers for the acquisition and legal due diligence;
- State Aid implications;
- Tax treatment;
- Type and value of security
- Procurement issues;
- Know your customer;
- Political, environmental and social factors; and
- Accounting treatment.

12.4.3 Where necessary and dependent on the value of the proposed investment, external advice will be sought by officers before entering into financial investments.

12.4.4 Where possible, the council obtains appropriate security such as a legal charge on property before making loans. It should be noted that a number of these investments are funded by grants or other third party contributions, and thus carry no risk of loss to the council as a result of entering into them.

12.4.5 Of the £44.7m of current financial investments shown in the table in 12.3.2 above, £38.6m (86.4%) are either secured on property or relate to an underlying property asset.

12.4.6 As regards liquidity, the council does not set any maximum policy limit for the duration of such investments, with each being judged on a case-by-case basis. Indeed, equity loans to homeowners, which are partly funded by grants and other contributions, have no set maturity date. When making non-financial loans and

investments the council does so with the understanding that it will not be able to prematurely access the funds which have been committed to these investments.

12.4.7 All decisions to enter into non treasury financial investments are taken within the council's overall delegated decision framework, with the added requirement included in Financial Regulations for the decision maker to consult with the Chief Finance Officer before entering into such a contract. The requirement to consult the Chief Finance Officer ensures that the available knowledge and expertise within the council for assessing such contracts is applied to each such decision.

12.4.8 Under the new requirements for investment strategies, the council is required to set a limit on the total value of non-treasury management loans which it is willing to make. The council proposes to set this limit for 2019/20 at £40m. From the table at 12.3.2 it can be seen that the total value of such loans made at 31st January 2019 is £2.9m. This limit does not relate to financial investments other than loans.

12.4.9 Once loans and financial investments have been made, the relevant service will be responsible for ongoing monitoring and for ensuring that amounts due to the council are recovered.

12.5 Commercial Property Investment Strategy

12.5.1 The Council's holds a mixed property portfolio spread across the following headings:

- Operational assets that are need to operate front line and back office functions;
- Investment portfolio that provide an income stream to the Council, which is split into the
  - i) Prime Investment Portfolio comprising high yielding investment properties such as office blocks, the Arena, large modern industrial units and multi storey car parks,
  - ii) Commercially let properties including a portfolio of small industrial estates, offices, shops and pubs,
  - iii) Community assets such a sports clubs and community groups,
  - iv) Economic Development properties held for supporting innovation and job creation.
  - v) investment properties that have been earmarked to raise Capital Receipts,
  - vi) agricultural land and property held for long term strategic expansion of the city or protection of the countryside
  - vii) miscellaneous properties which include substations and other statutory utilities on Council land
    ;
- Regeneration and growth – assets that are acquired to enable transformation of areas, provide confidence to the market where particular projects have stalled and generate growth;
- Heritage assets – that's are of historic importance to the city; and
- Community assets - that are held to support initiates across the public and third sectors to the benefit of local communities.

12.5.2 The Council has held a number of investments assets that have generated an income stream. These assets cover commercial property and a small industrial portfolio as set out above and together with various other rights for example covenants, access rights and mineral rights.

12.5.3 On 21 October 2015 Executive Board considered a report from the Chief Executive entitled 'Strong Economy, Compassionate City' which was a response to the White Paper motion passed at July 2015 Council on sharing economic success in the city. The report advised how the Council had played a pivotal role in the economic recovery of Leeds having intervened proactively to kick-start development and regeneration projects, support businesses to grow and invest, and to help people to work. The Council had used its powers for land assembly at the Trinity and Victoria Gate schemes; brought forward its land at Sovereign Street; constructed the First Direct Arena; and pump primed the delivery of manufacturing and logistics space in the Leeds Enterprise Zone, amongst a few. The ambition for Leeds to have a strong economy and to be a compassionate city has now embedded in the Best Council Plan, with a council priority being to support economic growth and access to economic opportunities.

12.5.4 One of the main aims of the Council is to bring about economic regeneration in Leeds. The Council has been involved in bringing forward the development of buildings at a time when the market was stalling and their acquisition will further the Council's involvement and financial benefits. With the Council's ambition to become the best city in the UK, with an economy that is both prosperous and sustainable, further acquisitions offer the opportunity to further boost the performance of the Council's property investment portfolio with substantial rental income.

12.5.5 The Council will ensure that there is a proactive maintenance strategy in place to preserve the income that investment assets generate.

12.5.6 At the present time this strategy paper concentrates on the purchase of new assets. It is envisaged that a disinvestment strategy will be added at a later date to set the strategy for the sale / release of non performing low quality assets that the Council do not wish to retain.

12.5.7 In the longer term it is envisaged that the Council will put in place an active Asset Management strategy where none performing assets are either "engineered" to perform or traded out of the portfolio and replaced with others.

12.5.8 The Council will put in place a strategy to manage and make the best use of historic assets that will be retained by the Council. This is part of the Council's desire to have a managed efficient estate.

12.5.9 The opportunistic disposal of properties may also be considered to capitalise on market movements and situations where the return available is above market value such as special purchaser and marriage value situations. In addition certain acquisitions may be held on a short/medium term basis where a resale in the next few years might enable the Council to obtain an enhanced value before the asset value might start to fall e.g. to sell the investment before the remaining lease term becomes unattractive to the market.

12.5.10 Once the portfolio is in place it is recommended that the Investment Management Strategy is reviewed on a quarterly basis, and if required it will be amended to reflect changing Council priorities or changes to market conditions.

12.5.11 In addition the Property Manager or external Property Adviser will on a day to day basis be actively monitoring market conditions and the management strategy adopted will be adjusted to reflect changes in the market. The monitoring of market conditions is seen as essential if the Council is to capitalise on opportunities thrown up by changes in the commercial property sector. Further an important part of the long term strategy as the portfolio matures will be to look at portfolio weighting to ensure that the Council is not under or overexposed to one or more sectors of the market. To do this a summary of the value of the properties and the income

generated will be produced. This data will also be provided in a pie chart format for easy identification of holdings and returns in the various commercial property sectors.

12.5.12 The Council will use borrowing to fund property acquisitions. Borrowing will be sourced as outlined in the Treasury Management Strategy but could include the Public Works Loan Board. The rental income generated must as a minimum provide a surplus over and above the costs of borrowing.

12.5.13 Investment Criteria

When looking at investment properties the Council will have regard, in order, for security liquidity and then yield. The Council should consider the following factors as part of the selection criteria:

- Covenant Strength – A full financial appraisal of the ability of the tenant(s) to continue to pay rent to service the Council's debt obligations will be undertaken. This may in some cases require external independent advice. Only tenants of good financial standing will be considered.
- Unexpired terms: For let properties the Council must consider the unexpired length of the lease and break clause to determine the risk to future income assumptions. In addition the Council will consider the costs of a tenant vacating in future income assumptions.
- Guide Price: In order to avoid over exposure to large lot sizes and to avoid the purchase of low price and therefore low return investments that are uneconomical to manage it is recommended that the Council invest in properties within a value range of £5 to £65 million.
- Target Yield Range: The target return should as a minimum be higher than the cost of borrowing but also be in excess of returns that could be received on bank deposits. However appropriate adjustments for risk and growth should be factored in. An appropriate Yield minimum is currently 4% the present time under the current low interest rates. Lower initial yields should of course be considered for investments offering asset management or redevelopment opportunities or long term guaranteed rental growth i.e. linked to annual RPI or CPI increases which will give higher returns in the long term.
- Risk: concurrent with the rate of return the risk of the acquisition/tenant strengths and lease conditions should be evaluated.
- Location: Based upon knowledge of the local area and the regeneration requirement only properties in the geographical area of the Council's jurisdiction will be considered.
- Market Sector: Investments across all sectors will be considered. Particular emphasis should be placed upon investments that complement regeneration or job creation in the Council area which may involve the Council entering into Joint Venture arrangements.
- Capital Growth: The property should afford revenue and /or capital growth. Where at all possible properties selected should offer opportunities by asset management, change of use, reconfiguration or redevelopment to enable Leeds to produce future returns that will increase in real terms above inflation.

- Tenant Line up: In order to minimise the risk of tenant failure and property voids single occupancy properties should be avoided unless covenant strength is exceptional (institutional single covenants or strong local firms e.g. banks or local legal firms) and there is a significant unexpired term. In terms of multi-occupied properties preference should be given to investments with a variety of uses / trades but ensure the number of tenants is manged to covenant strength.
- Vacant Properties: In certain circumstances such properties should be considered particularly if they adjoin existing Council holdings, or offer opportunities by asset management, change of use, reconfiguration or redevelopment. Vacant properties will also be considered where they are in areas of strong growth and investment activity such as the Aire Valley where it is anticipated there will be interest from occupiers and therefore good prospects of letting. The advantage of such properties is that they can be usually purchased at a discount to the market and are a way of adding value by letting to strong covenants. Such properties will also provide inward investment opportunities for the City as ready-made sites for new occupiers.
- Property Condition: for let acquisitions the age and condition must be sufficiently factored into the price to ensure that the Council is in a position to let or sell the property in the future and that appropriate surveys are undertaken prior to the purchase of the property. The Council should also consider the costs of refurbishment/demolition in the acquisition value.
- Market Sector: the Council should ensure that it has a balanced portfolio mix spread across the commercial property sector.
- Prime / Edge of Prime High Street Retail Uses: It is essential that any retail investments considered should meet the strict tenant covenant strength test. With the rise of internet shopping this has become a high risk of tenant failure sector. Care should be taken to avoid over exposure (say over 50% of uses) of the investment to any single use category. In particular Class A2 retail (banking and professional services) with break clauses or short unexpired lease terms should be avoided as there is a growing trend for banking and financial services companies to pull away from the high street.
- Car Parks: Consideration should be given to the acquisition of car parks as these provide a strong and guaranteed rental growth. Further in the case of lease expiry, or restructuring or tenant failures there is the opportunity for the Council to gain full control and take over the operation of the car park.
- Development Opportunities Adjoining / Abutting Existing Council Holdings: Opportunities where the Council has an interest in a site or owns adjoining land should be considered.
- Lease Re-gearing, Unlocking of Marriage Value and Purchase of Freehold opportunities: It is possible to unlock latent value or create new value and income by the extinguishment variation or extension of long leasehold terms such an example would be the restructuring of the lease on the offices at Merrion House. The other example is the redevelopment of the George Street shops whereby the existing rental is cannibalised to enhance the future of the site and obtain an increased asset value. Consideration should also be given to buying in the freehold of council leased in properties where prudential loan repayments are lower than contractual rental payments.

- Maintenance Programme: The revenue and capital implications of maintenance the assets should be considered and reflected in budget assumptions and an adequate budget is set aside to cover future maintenance that is not recoverable through a service charge and potential future refurbishment costs..

Property Criteria that should be avoided.

When appraising potential investments the following property types / situations should be avoided.

- Leasehold: Due to management issues relating to superior landlords plus diminishing returns such investments should be avoided unless there is a significant lease term remaining normally in excess of 100 years or the opportunity to renegotiate the lease term as part of the acquisition.
- Speculative Development sites: Commercial development is a high risk / high return industry and given the need for an immediate income return on investment it is not recommended that the Council invest in this area unless adequate pre lets are in place unless there is a good regeneration criteria linked to the purchase of such an asset.
- High Risk Complex Joint Ventures: Such opportunities can present good returns by sharing the risk with others. Such opportunities should be considered carefully and considered in the context of their regenerative benefits in the longer term.
- MEES Compliance: From the 1 April 2018 under the energy efficiency requirements of the MEES compliance all commercial properties offered to let must have a minimum EPC rating of “E” or above. Therefore any properties not meeting this criteria should be avoided unless the seller undertakes the necessary enhancement works to make the property MEES compliant.
- Shopping Centres: Such investments require intensive management and frequently impose future cash calls for refurbishment etc. upon their owners. In addition, Leeds has a very comprehensive retail offer at present and investment in to this market is likely to exceed the funds available. The sector is likely to be competitive with other investors such as commercial property companies and funds therefore entry costs could be high with yields lower. Therefore investment in this sector is not recommended. It should be noted that other Local Authorities have acquired retail shopping centres but these tend to be acquired either to support the town centre or the regeneration of an area of the city.
- Retail Parks: In a similar fashion to shopping centres such investments carry intensive management obligations and the frequent need to put extra investment into the asset. The retail market has been adversely affected by the way people buy goods and through online purchases of goods and the viability of such retail sites have to be very carefully assessed. The DIY sector is also being hit by the rise in “trade park” operators such as Screwfix who can operate from such parks at rents nearer industrial rates than those higher rents seen at retail parks.

12.6 **Commercial Property Investment Activity to date**

12.6.1 As at 31st January 2019 the council has acquired a number of investment properties. The total acquisition cost of these properties was £78.6m, and the carrying value at the most recent valuation was £83.9m. The fair value of these assets will be revalued as part of the 2018/19 closedown process and any resulting reduction in fair value below the level of capital invested would be reported to full council as required by the statutory guidance on investments, along with mitigating actions proposed. The following table provides details of individual asset values:

Asset	Purchase Price / Build Cost £	Stamp Duty & Other Fees £	Total Cost £	Latest Valuation £
Harper Street Car Park	10,025,000	503,600	10,528,600	12,000,000
Sovereign Square (offices)	43,993,350	1,262,750	45,256,100	50,000,000
Thorpe Park (offices)	7,020,000	530,900	7,550,900	7,020,000
Logic Leeds (industrial unit)	6,250,000	444,500	6,694,500	6,400,000
Apex View (offices)	8,003,323	524,715	8,528,038	8,437,018
Total	75,291,673	3,266,465	78,558,138	83,857,018

12.6.2 In addition to making a financial return, all of the above investment properties were acquired with a view to stimulating economic development in the city, and the Harper Street Car Park makes a further contribution in providing a parking service to residents and visitors.

12.6.3 The following table identifies the projected net yield from these assets for 2018/19 :

	2018/19 Estimated Outturn				
Asset	**Annual Prudential Borrowing Charge** **£**	**Gross Income** **£**	**Net Income** **£**	**Yield** **%**	**Return on Investment** **%**
Harper Street Car Park	510,000	(664,085)	(154,085)	6.31	1.46
Sovereign Square (offices)	1,401,000	(1,923,000)	(522,000)	4.25	1.15
Thorpe Park (offices)	234,000	(418,238)	(184,238)	5.54	2.44
Logic Leeds (industrial unit)	207,000	(452,704)	(245,704)	6.76	3.67
Apex View (offices)	331,000	(572,000)	(241,000)	6.71	2.83
Total	**2,683,000**	**(4,030,027)**	**(1,347,027)**	**5.13**	**1.71**

12.6.4 An assessment of current values against acquisition values shows that for some assets there has been a small loss in capital values. However the assets were acquired with the aim of medium to long term income generation, rather than with the aim of generating a capital return via a disposal in the short term. As regards liquidity, the council took into account the inherently illiquid nature of property assets in its business cases for the acquisition of these investments, and does not anticipate being forced to dispose of them under disadvantageous market conditions. This view is based on the soundness of the council's overall financial governance arrangements,

which minimise the risk of any unexpected need to realise funds from the properties. However, the council will continue to monitor the property market to ensure that it identifies any opportunities which do arise to generate a capital gain from the disposal of the assets.

12.7 **Proportionality**

12.7.1 The statutory guidance on investment strategies requires the council to disclose the extent to which it is dependent on profit generating investment activity as a source of income to balance its budget.

12.7.2 The council's income from non treasury financial investments is negligible in the context of its overall income, and therefore the potential for failure to generate the expected level of investment income presents no risk to the council's overall financial standing.

12.7.3 Similarly, the council is not dependent on the generation of income from its investment property assets to any great extent, and thus the potential for a reduction in the income generated from them does not represent a significant risk to its overall financial standing.