

## The Highland Council

City of Inverness Area Committee – 4 March 2014

Agenda Item	9a
Report No	CIA/07/14

### **Inverness Common Good Fund Review of Investment Strategy and Capital Planning**

### **Joint Report by Director of Finance and Acting Head of Community and Democratic Engagement**

#### **Summary**

This report confirms the existing investment strategy for the City of Inverness Common Good Fund (ICGF), sets out the current governance arrangements, provides an update on the review of the investment strategy, and confirms existing and potential financial commitments.

#### **1. Background**

- 1.1 The ICGF is a significant fund that is administered by the Highland Council on behalf of, and for the benefit of, the citizens of the former burgh of Inverness. Whilst the Fund has operated successfully for several years, building up a significant portfolio of property and cash assets, members of the Area Committee have requested that a review of the investment strategy, and the purposes to which annual income and expenditure is used, is carried out to ensure that the current strategy is fit for purpose and to ensure that the Fund is managed so as to provide maximum benefit for local citizens.
- 1.2 The current strategy has not been reviewed for some time, and there are varying views as to what the optimum uses of the Fund may be. The review that is currently underway will clarify what options are available to the City of Inverness Area Committee (CIAC) to consider, and outline the financial implications of each.
- 1.3 The review also considers current commitments and how these will require to be funded, making reference to the latest financial position of the ICGF.

#### **2. Current Governance Arrangements**

- 2.1 The total value of the ICGF is under the governance of the Highland Council. This is not controlled by Trust Deed, but by principles laid down in legislation and case law.
- 2.2 In order to ensure the efficient and effective management of the assets, the Council has agreed that the CIAC has the power to administer the assets of the Fund.

2.3 Administration of the assets comprises of the following:-

- (i) Land and buildings – to ensure that assets are adequately managed and maintained;
- (ii) Investment Properties – to ensure that commercial tenancies deliver a market value return. Advice is also given on the investment requirements of the property portfolio, and on potential sales and purchases;
- (iii) Equity Investments – stocks and shares are managed through the Investment Sub-Committee, with day to day management undertaken by the Fund Managers (Messrs Adam & Co);
- (iv) Heritage Assets – these are tangible assets with historical, artistic, scientific, technological, geophysical or environmental qualities that are held and maintained principally for their contribution to knowledge and culture.

2.4 Whilst the CIAC is responsible for the administration of the Fund, any significant decisions regarding the acquisition or disposal of assets require to be taken by the Highland Council.

### 3. Current Investment Strategy

3.1 The table below shows the current assets of the ICGF, based on the audited accounts as at 31 March 2013.

	£	£
<b>Non-Current Assets</b>		
Investment Properties	20,719,000	
Community Assets		
Investments at Valuation	10,342,005	
Heritage	<u>1,638,000</u>	
<b>Total Non-Current Assets</b>		<b>32,699,005</b>
<b>Current Assets</b>		
- Debtors	97,375	
- Loans Fund Deposits	375,853	
<b>Current Liabilities</b>		
- Creditors	<u>(196,379)</u>	
<b>Net Current Assets</b>		<b><u>276,849</u></b>
<b>Total Assets</b>		<b><u>32,975,854</u></b>

3.2 The accounts show that whilst the ICGF is “asset rich” it is actually “cash poor”. By this it means that the Fund has no (or little) cash assets to draw on to finance either capital expenditure, or revenue expenditure in excess of annual income.

- 3.3 Equity Investments provide an annual dividend that is reinvested in the Equity Portfolio to provide capital growth. At the 31 December 2013 the value of these investments was £10.9m. Whilst investments can increase or reduce in value, over time the Portfolio has shown a significant growth in capital value.
- 3.4 The Property Portfolio consists of general and historic assets, for example the Town House, but the most significant proportion of the Portfolio consists of Investment Properties. Rental from these provides an annual income stream that is then used to finance maintenance costs associated with the Portfolio, with the majority of income available to finance grants, events and initiatives within the City.
- 3.5 Investment Properties provide an annual income of around £1.9m, equivalent to 9% of asset value. This is a very high return, for very little financial outlay or risk. As such the Investment Property Portfolio represents a significant asset.

#### **4. Review of Investment Strategy – Progress to Date**

- 4.1 Two informal meetings have been held with members to the CIAC to discuss options for the Fund.

##### ***Property Assets***

- 4.2 In terms of heritage assets there are very few options available to the CIAC, other than to fulfil its obligations to protect these assets for future generations. The main focus of the discussion has therefore focussed on the Investment Portfolio.
- 4.3 As stated above, the Investment Portfolio provides a high investment return for very little financial outlay or risk. As such this is an asset that would provide a substantial capital sum if all, or part, was sold. However there are a number of issues to consider:-
- (i) the £1.9m annual rental income is firstly required to meet the costs involved in managing and maintaining the CGF assets. Approximately £0.6m is required for this purpose, meaning that a maximum third of the portfolio would have to be retained to maintain (at least) this level of income;
  - (ii) the remaining income is used to finance revenue expenditure on grants to individuals and community groups, and to support a range of economic and tourist related activities across the City. If the portfolio is sold then there will be no alternative source of income to fund any of this current activity;
  - (iii) consideration has also been given to selling part of the portfolio to provide capital that would enable the ICGF to acquire new properties e.g. empty properties in the City Centre. However any alternative would provide a much lower level of income, and have much the same impact as (ii) above.

- 4.4 If the Committee is minded to establish a fund to acquire additional properties, then an alternative course of action would be to set aside an element of the annual rental income stream to create a new fund for further developments. If this option was considered, then the Committee would not have the same level of financial resource to support the existing level of activity outlined in 4.3 (ii) above.
- 4.5 Taking all the above factors into account, the initial recommendation from this review is to retain the existing property investment portfolio.

### ***Cash Investments***

- 4.6 Paragraph 3.3 highlighted the current strategy. The value of the portfolio was £10.3m at 31 March 2013. Whilst the capital value can increase or decrease, by 31 December 2013 the capital value had increased to £10.9m.
- 4.7 Cash investments are managed by an external fund manager, and have generally outperformed the benchmark set by the Council. Capital growth is a combination of reinvestment of share dividends and increase in asset value.
- 4.8 Investment in the Stock Market can be volatile and carries a higher level of risk. However it generally provides a higher return over the longer period.
- 4.9 Cash investments are really the only asset of the ICGF that can be realised at relatively short notice. As such, cash is withdrawn to finance any capital expenditure or revenue budget overspend or additional commitment. This practice, whilst the only practical option, does not sit well with a long term investment strategy of capital growth. Short notice withdrawals will impact on investment returns, so should be planned well in advance where possible.
- 4.10 Whilst no immediate change in existing practice is proposed, the current and potential commitments, outlined in Section 5 below, will have a major impact on the existing cash investment balance.

### ***General Conclusions***

- 4.11 There is a perception that the ICGF has significant funds that are available to provide significant grants for a range of different purposes. The reality is quite different.
- 4.12 The ICGF has significant assets, but there are implications of changing existing policy. Once assets are disposed of, they are not replaceable. If property assets are sold, revenue income reduces and the ICGF cannot support other initiatives. Cash investments are not replaceable if sold.
- 4.13 The ICGF does not have a separate income stream, and relies on its budget being balanced each year. There are no new funds that the ICGF can access, other than to borrow. If the CIAC wishes to increase existing funds, then it will have to reduce expenditure in order to generate a budget surplus, and to do this over a number of years in order to accumulate a fund of sufficient value.

## 5. Existing and Potential Financial Commitments

5.1 At present the ICGF has the following commitments. Although some of these are revenue commitments, and others capital, the only source of funding available is the Cash Investment portfolio. These commitments can only be funded through the sale of stocks and shares to realise the cash necessary for either capital or revenue expenditure.

	£000	Fund Balance £000
Cash Investments value as at 31.12.13		10,850
<b>Revenue Commitments</b>		
Grants committed but not drawn down		387
<b>Capital Commitments</b>		
Town House Refurbishment	100	
CGF contribution to re-wiring of Town House	51	
Refurbishment 1-3 Church Street	917	
Streetscape Riverside Flood Prevention Project	800	
Victorian Market Windows Replacement	40	
Inverness City Arts Project	<u>225</u>	
		2133 =====
Balance		8330 =====

5.2 Later on today's agenda the CIAC will consider proposals for the proposed Town House Renovation project. This will require approximately £7.25m to be made available over the next five years. As can be seen from the Table above, this will significantly reduce the existing Fund balance to £1.08m, resulting in reduced scope to support any new projects in the foreseeable future.

## 6. Future Work

6.1 This report has outlined the review work to date, and makes some initial recommendations around the Property Investment Portfolio. However this is only the start of the review, and further work is required to:-

- Prepare a cash flow statement over the 5 year period to 31.3.19
- Analyse existing revenue expenditure commitments
- Consider options for investment
- Consider links to the Council's programme to enhance economic activity
- Consider strategy options and how these link to, and support, existing Council services
- Consider alternative sources of funding for projects, including external sources

6.2 A further report will be presented to the next meeting on 3 June 2014.

**7. Resource; Legal; Equalities; Climate Change/Carbon Clever; and Risk Implications**

7.1 There are no immediate implications however some of the projects submitted may deliver a reduction in carbon omissions in the future.

**Recommendations**

The Committee is invited to:-

- i. approve the progress to date on the review of the Strategy applied to the administration of the Inverness Common Good Fund;
- ii. agree that the Investment Property Portfolio should be retained; and
- iii. note existing and potential financial commitments.

Designation: Director of Finance and Acting Head of Community and Democratic Engagement

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