**Agenda Item No: 5**

# POOLED PROPERTY FUND INVESTMENT

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| *To:* | **Commercial and Investment Committee** |
| *Meeting Date:* | **22 February 2019** |
| *From:* | **Chief Finance Officer** |
| *Electoral division(s):* | **All** |
| *Forward Plan ref:* | **N/a** *Key decision:* **No** |
| *Purpose:* | **To receive information about a pooled property fund investment, for treasury management purposes** |
| *Recommendation:* | **The Committee is invited to:** |

- **Note a direction by the Chief Finance Officer, under the auspices of the treasury management strategy, to invest up to £16.5m in the CCLA property fund**



| | ***Officer contact:*** | | ***Member contact:*** |
|---|---|---|---|
| Name: | Tom Kelly | Names: | Councillor J Schumann |
| Post: | Head of Finance | Post: | Chairman |
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## 1. BACKGROUND

1.1 The Commercial & Investment Committee, through its Commercial Board and Investment working group, oversees appraisal of commercial property investments. This activity is stepping up, with ambitious targets set within the business plan for re-investment of the £90m-£100m capital receipts expected to be generated from sales to This Land (the Council's wholly owned housing development companies).

1.2 Since late 2016, a number of sites located throughout the East of England and Midlands have been considered by the County Council for potential acquisition. There has been one significant purchase to date (Brunswick House), which also aligns with inward economic investment objectives, and other proposals are under consideration. However, it will take time to build up a balanced commercial property portfolio directly owned by the Council; on a number of properties considered so far the Council has either been outbid or declined acquisition on the basis of yield and risk.

1.3 At the same time, guidance issued to local authorities during 2018 from the Ministry of Housing, Communities and Local Government, as well as CIPFA, has strongly cautioned against "borrowing in advance of need" specifically for investments with a purely commercial return. Individual property investments outside of the local area require the Council to have a clear funding source, established powers to invest in that way and/or asserting a conscious disregard to the statutory guidance.

1.4 In this context of a restricted and competitive local market of appealing potential property acquisitions and a tightening regulatory framework, this report updates the Committee on a specific pooled property fund investment which the Council now intends to advance alongside the acquisition of specific properties: CCLA. Investment in this pooled property fund offers important diversity in investment, a proven track record of yield and return to other local government bodies as well as accounting advantages.

## 2. CCLA LOCAL AUTHORITIES PROPERTY FUND

2.1 CCLA (originally standing for Charities, Churches and Local Authorities) is a large UK fund manager, particularly focused on public and third sector investors. The Local Authorities Property Fund, operated by CCLA, has close to £1.1bn invested in property across a broad range of sectors (from offices and hotels to industrial/logistics) and throughout the regions of the UK. Unlike the Council's direct acquisitions approach described in paragraph 1.2, investment in the fund does not confer ownership of specific properties, instead all of the investors receive the combined risk and reward of all of the fund's assets collectively. This spread enables the fund to hedge risk and optimise the return, over the long term, to investors. **Appendix 2** is the factsheet published by the fund. **Appendix 1** is the Key Information Document published by the fund.

2.2 The income element of the return has been consistently paying around 5% per annum since 2010. The fund deducts a management charge of 0.65% from this gross return. This compares to the interest rate currently achieved by the Council in instant access money market funds of 0.75% and typical medium to long-term investment rates of 1.5%.

2.3 Any investment needs to be viewed as being for the medium to long-term. There is a spread of 8.3% between the bid and offer price of each unit purchased in the fund, reflecting costs of property transactions. To be sure of recovering this and overcoming any short-term fluctuations in market property values, the investment needs to be considered as likely to be held for a minimum of 3-5 years.

2.4 The spread between the bid and offer price would immediately reduce the Council's holding value by £83k for every £1m invested. The annual growth in the capital value of the fund in the past 12 months has been 3.08%. Should this rate of growth continue and apply evenly, it would overcome the spread between the bid and offer price within 3 years, with opportunities for further growth in the underlying value of the investment thereafter (hence the minimum suggested duration outlook of 3-5 years). This is however only an estimate of future growth based on evidence from the past so should be treated with caution. Future growth will depend on how property markets and the fund assets perform. The Council's priority is a predictable revenue income stream which the CCLA fund delivers in the short term, meaning that recovery of the capital value can take place over the longer term.

2.5 234 local authorities and similar bodies currently invest in this fund. This includes the Council's LGSS partners Milton Keynes Council, who invested £15m in two tranches (£10m in March 2015 and a further £5m in February 2016). The first tranche recovered the spread between the bid and offer price in 30 months, the second tranche is yet to recover the initial spread but is projected to do so within the next 6 months. Northampton Borough Council undertook its first investment in the fund of £8m in November 2018.

## 3. TREASURY MANAGEMENT STRATEGY AND ACCOUNTING CONSIDERATIONS

3.1 One of the major advantages of CCLA is that it has been designated, in England, as a Local Authority Investment Scheme by HM Treasury under section 11 of the *Trustee Investments Act 1961*, and there is therefore an option not to treat it as capital expenditure under regulation 5 of the Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2010. CCLA has this advantage as its trustee is ultimately controlled by representative bodies of local authorities (including the Local Government Association) amongst other "for-more-than-profit" organisations. It is the only property fund with such a designation.

3.2 In short, the Council receives the same financial benefits from CCLA under a treasury management treatment but without needing to finance this through the capital budget. It does not need to utilise capital receipts nor does it require a justification of additional borrowing under the statutory guidance on investments.

3.2 This enables the Council to make investments in CCLA for treasury management rather than capital purposes. This is to say it is treated as part of the overall management of the Council's investments, cash flows and transactions rather than as a capital scheme, creating or maintaining an asset, for its own sake. From this perspective, it may be sensible for the Council to align its investment with cash-backed amounts held on the balance sheet that it expects to remain there in the medium to long term. An investment approaching £16.5m, for instance, could be equated to the Council envisaging it will always target holding general fund reserves at least at that level – this is the Medium Term Financial Strategy planning basis. It should be stressed that this is an illustrative link and rationale, and that investing in a pooled property fund would not compromise the Council's ability to draw on the general fund, and access cash, due to in-year overspends or in response to sudden or unexpected events.

3.3 Investing in the CCLA for the medium to long-term in this way does effectively reduce the amount of funds available as internal borrowing for capital schemes and will bring forward the need to undertake additional borrowing. For both cash management and accountancy purposes this will be worthwhile as long as the yield from CCLA exceeds the cost of additional borrowing and/or compares favourably to alternative treasury management investment products. Interest on a fixed five year loan from PWLB is currently around 1.7%. Investing in money market funds (a highly liquid treasury management instrument) returns a yield of less than 0.75%. Our external treasury management advisor has also suggested the Council consider transferring some funds to less liquid and better yield investments (such as CCLA) and away from money markets, and that it can comfortably do so without compromising its cash position.

## 4. DECISION MAKING AND APPRAISAL

4.1 The Council's existing Treasury Management Strategy (section 8 – investment criteria) has permitted investment by the Council in property funds for some time. The Council has stated that it will consider property fund investments on an individual basis, invest a maximum of £20m in any single fund.

4.2 The Treasury Management Strategy (section 5 – investment position), adopted by Full Council at the budget meeting earlier in February 2019 included a revision to another indicator which now paves the way for investment in CCLA. Until that revision, the Council had also specified that the maximum sum that could be invested for longer than 364 days is £0 (nil). The Council would need to enter CCLA with an investment perspective exceeding 364 days. Taking account of similar limits in place at other Councils [Oxfordshire £150m, Gloucestershire £200m, Milton Keynes £50m, Peterborough £10m for instance] the limit agreed for the year ahead at CCC has been raised from zero to £50m.

4.3 Given this policy revision, a sub-group of the Committee, comprising Cllrs Schumann, Rogers, Jenkins and Jones met with the LGSS Treasury Manager and the Chief Finance Officer to receive a presentation from representatives of CCLA. The presentation from CCLA included discussion of:

- The fund's approach to "active management" of the property portfolio, with examples across asset classes and around the country of increasing value
- Diversity of rental income and expiry dates
- Low risk tenant ratings
- Annualised total returns (across revenue and capital) of 10.44% on a five year basis (fund competitors = 10.2%), 8.7% over 10 years (competitors = 7.47%)
- Medium term economic risks, and how the fund was positioned to respond to these.

4.4 Treasury management is delivered according to the treasury management strategy agreed by Full Council, with a delegation to the professional judgement of officers as to operational implementation. Further to the prospectus and presentation received from CCLA, the positive feedback from Members in response, and after taking account of the advantages and risks of this fund summarised in this report, the Chief Finance Officer has directed that the LGSS Treasury Team take steps to begin investment into the CCLA Property Fund in the coming weeks. To manage possible property value fluctuation risk, investment will be managed across two tranches together totalling up to £16.5m before further review: two thirds in the first tranche (£11m) with the remainder at an appropriate point thereafter.

## 5. ALIGNMENT WITH CORPORATE PRIORITIES

### 5.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

### 5.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

### 5.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

## 6. SIGNIFICANT IMPLICATIONS

### 6.1 Resource Implications

The resource implications are set out within the main body of the report, comparing favourably to treasury management alternatives.

### 6.2 Procurement/Contractual/Council Contract Procedure Rules Implications

As set out in paragraph 3.1, the fund has unique accounting advantages, due to its designation and the role of the Local Government Association within the trustee.

### 6.3 Statutory, Legal and Risk Implications

The CCLA property fund carries a comparatively low level of risk as a form of property investment because the pool contains a wide portfolio of assets in different location and different commercial sector. Economic downtown affecting one sector will be mitigated by holdings in other sectors. The income generated by the Fund has, however, remained consistent over time and the capital value has increased over the long-term.

Whilst an increase in property values would have a positive impact, changes in accounting practice (IFRS9) would mean that the impact of changes in underlying property values could be reflected in a direct charge to the Council's revenue accounts based upon a point in time valuation. Following consultation, MHCLG have introduced a mandatory statutory override requiring local authorities to reverse out unrealised movements resulting from pooled investment funds. This is effective from 2018 and will apply for five years. The Government will keep use of the override under review. Should the override be withdrawn, the Council will consider the impact of a direct charge to the Council's revenue accounts.

### 6.4 Equality and Diversity Implications

There are no significant Equality and Diversity implications.

### 6.5 Engagement and Communications Implications

There are no significant Engagement and Communications implications.

### 6.6 Localism and Local Member Involvement

This is an investment in a national property fund, with no direct local implications.

### 6.7 Public Health Implications

There are no significant Public Health implications.

| **Implications** | **Officer Clearance** |
|---|---|
| | |
| **Have the resource implications been cleared by Finance?** | Tom Kelly, *Head of Finance*<br>Carl Oliver, *Treasury Manager* |
| | |
| **Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement?** | n/a |
| | |
| **Has the impact on statutory, legal and risk implications been cleared by LGSS Law?** | n/a |
| | |
| **Have the equality and diversity implications been cleared by your Service Contact?** | n/a |
| | |
| **Have any engagement and communication implications been cleared by Communications?** | n/a |
| | |
| **Have any localism and Local Member involvement issues been cleared by your Service Contact?** | n/a |
| | |
| **Have any Public Health implications been cleared by Public Health** | n/a |

| **Source Documents** |
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| ***www.ccla.co.uk*** |

**Appendix 1**

# KEY INFORMATION DOCUMENT

CCLA

## Purpose

This document provides you with key information about this investment product. It is not marketing material. This information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products.

## Product

| | |
|---|---|
| Fund Name | The Local Authorities' Property Fund (the "Fund") |
| Income Units (ISIN) | GB0005216642 |
| Name of manufacturer | CCLA Fund Managers Limited (the "Manager") |
| Website | http://www.ccla.co.uk |
| Client Services | 0800 022 3505 |

The Manager is authorised and regulated by the Financial Conduct Authority.

As of 1 October 2018.

## What is this product?

### Type

The Fund is an open-ended unregulated collective investment scheme. The Fund is an alternative investment fund and managed by the Manager in accordance with the Alternative Investment Fund Managers Directive (2011/61 EU), the Alternative Investment Fund Managers Regulations 2013 (SI2013 No. 1773) and the Commission Delegated Regulation (EU) 231/2013.

### Objectives

The Fund aims to provide investors with a high level of income and long-term capital appreciation. The Fund provides investors with exposure to an actively managed portfolio, principally invested in UK commercial properties although it may invest in other assets. For certain purposes set out in the Scheme Information document, and with the prior written approval of the Trustee, the Manager may borrow up to the limit of 50% of the net asset value of the Fund.

### Intended retail investor

The Fund is restricted to local authority investors who should have the ability to bear losses. It may not be appropriate for those with an investment horizon of less than five years.

The Fund does not have a fixed duration. If the Trustees holds the opinion that winding-up the Fund is in the interests of investors then, after due notice, the Trustees will realise the property of the Fund and distribute the net proceeds to investors on a pro-rata basis.

## What are the risks and what could I get in return?

### Risk indicator

Lower risk ← → Higher risk

**Typically lower rewards** **Typically higher rewards**

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |

The summary risk indicator is a guide to the level of risk of this product compared to other products. It shows how likely it is that the product will lose money because of movements in the markets or because we are not able to pay you. The risk indicator assumes you keep the product for the recommended holding period of five years. Property is recognised as an illiquid asset and is thus most suited to long-run investment. The risk of the Fund may be significantly higher than the one represented in the summary risk indicator where the Fund is not held for the recommended holding period.

The Fund should be considered illiquid as it is not admitted to trading on a secondary market, and no alternative liquidity facility is promoted by the Manager or a third party.

We have classified this product as 2 out of 7, which is a low risk class. This rates the potential losses from future performance at a low level, and poor market conditions are very unlikely to impact the capacity of the Manager to pay you.

A more detailed description of risk factors that apply to this product is set out in the latest Scheme Information document, which is available on the Manager's website or by request.

This product does not include any protection from future market performance, so you could lose some or all of your investment. If we are not able to pay you what is owed, you could lose your entire investment. However, you may benefit from a consumer protection scheme (see the section 'what happens if we are unable to pay you'). The indicator shown above does not consider this protection.

**Performance scenarios**

| Investment scenarios | | 1 year | 3 years | 5 years |
|---|---|---|---|---|
| Stress scenario | **What you might get back after costs**<br>Average return each year | £9,072<br>-9.28% | £11,380<br>4.40% | £13,415<br>6.05% |
| Unfavourable scenario | **What you might get back after costs**<br>Average return each year | £9,497<br>-5.03% | £10,896<br>2.90% | £12,672<br>4.85% |
| Moderate scenario | **What you might get back after costs**<br>Average return each year | £10,018<br>0.18% | £12,003<br>6.27% | £14,380<br>7.54% |
| Favourable scenario | **What you might get back after costs**<br>Average return each year | £10,675<br>6.75% | £13,355<br>10.12% | £16,483<br>10.51% |

This table shows the money you could get back over the next five years, under different scenarios, assuming that you invest £10,000. The scenarios shown have been prepared as required under EU regulatory rules and illustrate how your investment could perform. You can compare them with the scenarios of other products.

The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies and are not an exact indicator. As future returns are unlikely to mirror the last five years, investors should treat these illustrations with caution. What you get will vary depending on how the market performs and how long you keep the product.

The stress scenario shows what you might get back in extreme market circumstances, and it does not take into account the situation where we are not able to pay you.

The figures shown include all the costs of the product itself but may not include all the costs that you pay to your advisor or distributor. The figures do not take into account your personal tax situation, which may also affect how much you get back.

## What happens if the Manager is unable to pay out?

The assets of the Fund are held for the benefit of investors by an independent Trustee, HSBC Bank Plc, and so are held separately from those of the Manager.

The Fund is not an authorised unit trust within the meaning of the Financial Services and Markets Act 2000, which means it is not covered by the Financial Services Compensation Scheme (FSCS).

Investors may however be eligible for compensation under the FSCS if they have claims against the Manager, Depository or other service provider of the Fund which is unable or likely to be unable to pay claims against it (for example where the firm has stopped trading and has insufficient assets to meet claims). Further details are available at https://www.fscs.org.uk

## What are the costs?

The Reduction in Yield (RIY) shows what impact the total costs you pay will have on the investment return you might get. The total costs take into account one-off, ongoing and incidental costs. The amounts shown here are the cumulative costs of the Fund itself, for three different holding periods. The figures assume you invest £10,000. The figures are estimates and may change in the future.

The person selling you or advising you about this product may charge you other costs. If so, this person will provide you with information about these costs and show you the impact that all costs will have on your investment over time.

| **Investment of £10,000** | | | |
|---|---|---|---|
| Scenario | If you cash in after 1 year | If you cash in after 3 years | If you cash in after 5 years |
| Total costs | 9.26% | 11.18% | 13.10% |
| | For an investment of £10,000, £926 | For an investment of £10,000, £1,118 | For an investment of £10,000, £1,310 |
| Impact on return (RIY) per year | 9.26% | 3.73% | 2.62% |
| | For an investment of £10,000, £926 | For an investment of £10,000, £373 | For an investment of £10,000, £262 |

The table below shows the impact each year of the different types of costs on the investment return you might get at the end of the recommended holding period and the meaning of the different cost categories:

| **This table shows the impact on return per year** | | | |
|---|---|---|---|
| One-off costs | Entry costs | 6.75% | The impact of the costs you pay when entering your investment. These are already included in the price. |
| | Exit costs | 1.55% | The impact of the costs you pay when exiting your investment. These are already included in the price. |
| Ongoing costs | Portfolio management costs | 0.22% | The impact of the costs of us maintaining underlying investments for the product. |
| | Other ongoing costs | 0.74% | The impact of the costs that we take each year for managing your investments including custody costs. |
| Incidental costs | Performance fees | N/A | The impact of performance fees on your investment. |
| | Carried interests | N/A | The impact of carried interests on your investment. |

### How long should I hold it and can I take money out early?

Recommended holding period is at least five years.

The Fund is intended for long term investors with an investment horizon of five years or more. This reflects the investment policy, the strategies likely to be used by the Manager and the costs of dealing in the asset class. The fund has no minimum holding period however and investors can request redemption at any time without penalty.

The Fund deals on the last business day of the month. Redemption requests must be received no later than on the business day prior to the dealing day.

Investors are reminded that commercial property can be an illiquid asset class and the Manager has the discretion to defer redemptions if it believes so doing is in the interest of investors and the good management of the Fund.

### How can I complain?

Complaints concerning the Fund and/or Manager should be referred to Client Services CCLA at Senator House, 85 Queen Victoria Street, London EC4V 4ET or emailed to client.services@ccla.co.uk

Complaints regarding the Trustee should be addressed to The Compliance Officer, HSBC Bank plc, Corporate Trustee of the COIF Charity Funds, 8 Canada Square, London E14 5HQ.

If you were advised on investing into the Fund, any complaints regarding that advice should be taken up with the party who provided it.

### Other relevant information

Income is paid in respect of the Fund for the preceding quarter at the end of January, April, July and October.

The minimum initial investment is £25,000; the minimum subsequent investment is £10,000.

CCLA have not considered the suitability of this investment against your individual needs and risk tolerance. To ensure you understand whether our product is suitable, please read the Scheme Information document for the Fund. We strongly recommend you seek independent professional advice prior to investing.