ARGYLL AND BUTE COUNCIL	POLICY AND RESOURCES COMMITTEE
CHIEF EXECUTIVE	18 DECEMBER 2014

INVESTING FOR INCOME

1 INTRODUCTION

1.1 Traditionally the Council has responded to financial challenges by looking at a range of measures to reduce costs. Investing for income would consider options to increase income. The key issue in increasing income is to look at new income streams rather than looking to charge more for the same. This would include considering how to use the free balance on the General Fund and also how the impact of this could be maximised through prudential borrowing. This would also contribute to the SOA outcomes with the potential for this investment to create additional jobs and help stimulate the economy. It would also be used to lever in matched funding. The Council needs to give careful consideration to this approach as there are very clear risks and mitigation measures would need to be developed to manage these risks.

2 RECOMMENDATIONS

2.1 The recommendations in relation to investing for income are set out in the covering report as part of a consolidated set of recommendations.

3 DETAIL

3.1 Background

3.1.1 The reports on investing for economic growth and strategic infrastructure plan set out proposals to support the SOA commitments to economic growth. The Council could support these proposals and the objective of economic growth further by seeking to develop a portfolio of investments that provided facilities or infrastructure but on a commercial basis that allowed the Council to earn income. It would be a statement of confidence that could assist in levering in additional external investment and it could also generate an income stream.

3.1.2 The financial outlook sets out a challenging financial position for the Council from 2016-17. Traditionally the Council has responded to financial challenges by looking at a range of measures to reduce costs. Whilst there has been limited consideration of mechanisms to increase income it is now imperative this is given consideration. An income stream arising from investing for income would increase the overall funding available to the Council and provide a further source of funding for capital investment or to mitigate future reductions in service budgets

3.1.3 Increasing income is not an easy option especially when the traditional "customer base" (those who would pay this income) i.e. population are reducing. There are also limits on what councils can charge for and realistically how much they can charge. The key issue in increasing income is to look at new income streams rather than looking to charge more for the same.

3.1.4 The Council had representation at a seminar in April 2014 in regard to public sector revenue generation. This was attended by councils and other public sector bodies. The seminar demonstrated:

- Councils had predominantly looked at income generation in terms of raising fees and charges.
- There was not a great deal of innovation in regard to income generation across the public sector with any innovation developed to deal with specific issues.
- There was no "silver bullet" in regard to income generation and each council must look at the opportunities that may apply to it.
- The opportunity to innovate and generate income (or preserve and protect budget/income) should be the driver and not the mechanism to achieve that e.g. Arms Length Organisations (ALO's), Limited Liability Partnerships (LLP's), Joint Ventures (JV's).

3.2 **General Fund Balance**

3.2.1 The Council considered a report on reserves and balances as part of the budget in February. As part of that consideration the Council:

"Acknowledged the significant challenges facing Argyll and Bute and the importance of supporting economic growth, addressing population decline and ensuring a viable and sustainable future for our area. In light of this, and

the objectives set out in the Single Outcome Agreement, the Council seeks to promote economic growth, create new jobs and increase the population through the development and delivery of an economic strategy that will support the outcomes in the Single Outcome Agreement, and

Further agreed to earmark the projected free General Fund Reserve in support of delivering the Single Outcome Agreement objectives with a report setting out (1) the process for considering the options for and proposals on use of the free General Fund Reserve for the purposes specified, and (2) the process agreed in relation to service prioritisation and review being submitted to the Policy and Resources Committee in August 2014."

3.2.2 At its meeting on 21 August 2014 the Policy and Resources Committee agreed *"the use of the free balance on the general fund be directed exclusively to the theme of economy and jobs and proposals to increase income / reduce costs for the Council"*. Whilst not a formal earmarking it is a statement of intent to utilise the balance on the General Fund to support the theme of the economy and jobs and proposals which improve the longer term financial outlook of the Council by increasing income or reducing costs. The report to the Policy and Resources Committee on 18 December 2014 in regard to reserves and balances monitoring advises that the current balance on the General Fund available for investing to support the SOA and increase income or reduce costs is projected to be £10.641 by March 2016.

3.2.3 Reserves can only be spent once. It is therefore essential that they are used sensibly to make the greatest impact on the Council's objectives.

3.3 Maximising the impact

3.3.1 Whilst the balance on the General Fund is significant on its own it is unlikely to make a huge contribution to the Council's financial position. Consideration needs to be given to how the impact of the General Fund could be maximised. Supplementing the General Fund Balance with prudential borrowing has the potential to create a much more substantial investment fund to generate an income stream that could make a significant contribution to the SOA delivery.

3.3.2 Councils have powers to borrow. Borrowing can only be undertaken to finance capital expenditure. Capital expenditure results in the acquisition, creation or enhancement of fixed assets – lending or investing in other organisations is not capital expenditure. In terms of the Prudential Code borrowing needs to be sustainable and affordable.

3.3.3 Councils have powers in relation to economic development. There are also duties and powers in relation to other services. Any proposal for income generation and borrowing will need to be consistent with these powers and duties. This will need to be considered on a proposal by proposal basis.

3.3.4 In addition to constraints around what counts as capital expenditure and borrowing there are constraints in relation to investment strategies. The Council would need to review its investment strategy if it wanted to take forward the proposals outlined in this report.

3.4 Benefits and Risks

3.4.1 There are clear benefits to the Council from looking to invest the General Fund Balance and supplementing this with prudential borrowing. The most obvious is an income stream that can support the Council's budget position and contribute to the SOA delivery. A further benefit is the potential for this investment to create additional jobs and help stimulate the economy.

3.4.2 The Council needs to give a balanced consideration to this proposal and there are very clear risks. More detail on the risks of individual proposals is set out later in this report.
- The investments made using the General Fund may not attract the return anticipated and indeed may be lost in total. In this case the Council has spent the General Fund Balance without any compensatory income.
- There is a risk that investment supported by prudential borrowing may not be successful in which case the Council in addition to not receiving an income stream is also left to meet the borrowing costs. This would make the Council's financial position worse not better.
- The risks outlined above may be a total or partial write off of an investment.

3.4.3 Mitigation measures will need to be developed to manage these risks. Whilst these will need to be relevant to individual proposals and projects this will in general terms include
- Detailed analysis of the business, risk and financial implications of any project.
- Spreading risk to ensure "all our eggs are not in one basket".
- Recognising this is an area of limited expertise and experience within the Council and engaging appropriate specialists with relevant skills and resources.
- Having a robust governance process for assessing, approving and monitoring the performance of proposals / projects.
- Engaging experts in the relevant field to provide advice.

3.5 **Options**

3.5.1 The Council has given some consideration to how it can develop a strategy to generate income, increase the effectiveness and efficiency of current budgets and provide investment and opportunity to grow the local economy. There are currently a number of areas that can be looked at to be pursued under these themes.

3.5.2 *Development Fund :*
- Consideration has been given to utilising the general fund reserve to invest in a number of possible areas. This was to: invest for a return; invest for job / economic development and creation of a loans fund / pool for business loans. The objective would be to achieve a commercial return that would also stimulate economic development and growth securing jobs to the area.
- Work now needs to be undertaken to assess the deliverability and effectiveness of such a fund. There is a need to examine:
  - Whether there are potential markets for such a fund.

  - How these markets can be accessed.
  - A business model that fully recognises risk of investment and secures return for the Council.
  - An operating model that will ensure that the fund is utilised on a business like and sustainable basis operating on a clear assessment of risk and within defined parameters.
- Discussion with Scottish Enterprise would be helpful to look at the potential for investment in the market, differing requirements and our ability to assist and tailor any offering we have by market sector.

3.5.3 *Street Lighting :*

- Development and Infrastructure services are now progressing with a street lighting project which has capacity to make savings. This utilises new LED lighting technology on a spend to save basis to make what may be significant savings in energy consumption, maintenance and lifecycle costs. Savings utilised can be captured and can help upgrade other areas of lighting infrastructure and improve sustainability in ongoing budget for the service. There is possible funding for assistance in delivering the project and this is being looked at by the service.

3.5.4 *Hub Investment :*

- Consideration is being given to investment in the junior debt element of hub projects in hubNorth area. The Council is liaising with hub to look at the pipeline of projects to ascertain likely funding level and timescale for completion. This offers an opportunity for a commercial return at approximately 10% of investment. The Council is unable to borrow to invest but can utilise its reserves to invest in accordance with its treasury policy. The income would generate sufficient to borrow further sums to replenish the general reserve fund and provide a funding surplus.

3.5.5 *Refinancing of the NPDO Project :*

- The refinancing of the NPDO project is being actively pursued. While there are challenges in the contractual process and the current commercial environment for a refinancing it is anticipated that the Council may make a likely return on the refinancing process of up to £1M. Once the issue of refinancing has been settled, that will allow a further review of possible areas for efficiency in the NPDO.

3.5.6 *Property :*

- There may be opportunities to look at increasing income from properties owned by the Council through looking at lease options to generate revenue rather than sale e.g. Dalriada House, Scotcourt and other properties in Dunoon/Helensburgh as new office rationalisation and CHORD comes into effect. It is intended that Estates review the property asset list to look at potential lease properties that may secure a higher return on a revenue basis and at the same time ensuring that income from leasing and rent reviews is maximised.

- This could be expanded to consider the provision of industrial and commercial property if a market existed for such facilities and any investment met the criteria of income generation and job creation/economic growth.

3.5.7 Each of the potential areas of investment set out above requires further investigation. At the level of the 5 categories above and also at any individual project level within any category there is a need to carefully analyse and consider the benefits (financial and non financial), issues, risks and governance. If members agree to develop these proposals further officers will proceed to undertaking a more detailed analysis of the benefits, issues, risks and governance for each category. At the same time officers will begin to develop the potential scale and scope of investment under each category. This work would also include considering identification and assessment of investment opportunities, due diligence over potential investments, managing the overall portfolio of investment, managing individual investments, governance over individual investments and governance of the whole portfolio.

3.5.8 The financial implications and scale of these proposals could be significant and have a material impact on the Council's financial position. However any investment involves risk and assessing and managing that risk is a key challenge if these proposals are taken forward. The following information is presented to allow members to get a feel for the potential impact of proposals at different scales and is not a guarantee of any level of income stream.

- If the Council simply uses the £10m free balance in the General Fund then depending on whether the investment earned 6%, 8% or 10% it would receive an income stream of £600k, £800k or £1m per annum.
- If the Council identified investment opportunities that met the criteria for capital expenditure at a value of £20m then in addition to the £10m in the General Fund it would borrow a further £10m at a cost of say 5%. At 6%, 8% and 10% this would generate income of £1.2m, £1.6m or £2m. The cost of borrowing over 30 years would be £600k leaving a net return of £600k, £1m or £1.4m. However if there was no return the Council would still be exposed to the annual borrowing costs of £600k.
- If the Council identified investment opportunities that met the criteria for capital expenditure at a value of £40m then in addition to the £10m in the General Fund it would borrow a further £30m at a cost of say 5%. At 6%, 8% and 10% this would generate income of £2.4m, £3.2m or £4m. The cost of borrowing over 30 years would be £1.8m leaving a net return of £600k, £1.4m or £2.2m. However if there was no return the Council would still be exposed to the annual borrowing costs of

£1.8m.

- If the Council identified investment opportunities that met the criteria for capital expenditure at a value of £60m then in addition to the £10m in the General Fund it would borrow a further £50m at a cost of say 5%. At 6%, 8% and 10% this would generate income of £3.6m, £4.8m or £6m. The cost of borrowing over 30 years would be £3m leaving a net return of £600k, £1.8m or £3m. However if there was no return the Council would still be exposed to the annual borrowing costs of £3m.

3.5.9 These are simply scenarios to give a feel for the scale and impact of different levels of investment and borrowing. In simple terms the purpose is to show that the higher the interest rate the greater the return, the more that is invested the greater the income stream and the more that is borrowed the more the Council is exposed to additional borrowing costs. They are not promoting a fund at a particular level or suggesting a given rate of interest is achievable. As indicated earlier there needs to be significant work done to investigate this proposal further and risk will need to be a key feature of any investment consideration.

4 CONCLUSION

4.1 The Council could consider investing for income as a means of increasing its income rather than focussing only on cost cutting. This could also help underpin some of the other investment in economic growth and the SOA. There are a range of potential opportunities but further investigation is required into the benefits, issues, risks and governance of the various options.

5. IMPLICATIONS

5.1 Policy – To be examined at next stage
5.2 Financial – To be examined at next stage
5.3 Legal – To be examined at next stage
5.4 HR – To be examined at next stage
5.5 Equalities – To be examined at next stage
5.6 Risk – To be examined at next stage
5.7 Customer Service - To be examined at next stage

For further information please contact Sally Loudon, Chief Executive 01546-604263

Sally Loudon
Chief Executive
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