

# **Watford Borough Council**

## **Capital Strategy**

**2019/20**



## 1. Introduction

- 1.1 The purpose of the capital strategy (the Strategy) is to tell a story that gives a clear and concise view of how the council determines its priorities for capital investment, decides how much it can afford to borrow and sets its risk appetite. It 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.
- 1.2 The framework the government uses to control how much councils can afford to spend on capital investment is known as the Prudential Framework. The objectives of the Prudential Code, which sets out how this framework is to be applied, are to ensure that local authorities' capital investment plans are:
  - affordable, prudent and sustainable;
  - that treasury management decisions are taken in accordance with good professional practice; and
  - that local strategic planning, asset management planning and proper option appraisal are supported.
- 1.3 This capital strategy sets out how Watford Borough Council will achieve the objectives set out above.

## 2. CAPITAL INVESTMENT PROGRAMME

### *Capital Investment Programme - Expenditure*

- 2.1 Capital Investment is the term used to cover all expenditure by the council that can be classified as capital under legislation and proper accounting practice. This includes expenditure on:
  - property, plant and equipment
  - heritage assets, and
  - investment properties.
- 2.2 Property plant and equipment includes assets that have physical substance and are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes. They are expected to be used during more than one financial year. Expenditure on the acquisition, creation or enhancement of these assets is capitalised on an accruals basis, provided that the Council is likely to benefit from the future economic benefits or service potential and the cost of the item can be measured reliably. Expenditure on repairs and maintenance is charged to the revenue account when it is incurred.
- 2.3 Heritage Assets are held with the objective of increasing knowledge, understanding and the appreciation of the Council's history and local area.

- 2.4 Investment properties are those that are used solely to earn rentals and/or for increases in value. The definition is not met if the property is used in any way for the delivery of services or production of goods or is held for sale.
- 2.5 The Council is currently has no external debt, with the exception of a loan from the Local Enterprise Partnership, so does not capitalise borrowing costs incurred whilst assets are under construction.
- 2.6 Detailed accounting policies in relation to assets and capital expenditure may be found in the annual statement of accounts.
- 2.7 Appendix 1 shows the latest MTFS position on the capital programme.

### ***Capital Investment Programme - Funding***

- 2.8 The Capital Investment Programme can be funded from the following sources:
- 2.9 Government Grants & Other Contributions: These are grants for specific purposes which may be available from the Government, e.g. Disabled Facility Grants. The Council can also attract partnership funding from other local authorities and agencies e.g. Local Enterprise Partnership (LEP). The Council has also benefited in the past from other funding such as lottery grants.
- 2.10 Section 106 Contributions: These are contributions from developers to the public services and amenities required for the development. These have been in part replaced by the Community Infrastructure Levy.
- 2.11 Capital Receipts: Capital receipts are derived when selling assets such as land. The main receipt relates to the arrangements made when the Council sold its housing stock to Watford Community Housing; the Transfer Agreement included a Right to Buy (RTB) Sharing Agreement whereby the Council is entitled to a share of the post-transfer receipts from RTB sales and a 'VAT Shelter Agreement' whereby the Council benefits from the recovery of VAT on continuing works carried out by Watford Community Housing.
- 2.12 Revenue Contributions: Revenue balances from the General Fund may be used to support capital expenditure.
- 2.13 Capital Expenditure Reserves: The Council has reserves which it has put aside for capital expenditure.
- 2.14 Borrowing: The Council is allowed to borrow to support its capital expenditure as long as this is prudent, sustainable, and affordable. Whilst the Council does not currently borrow, with the exception of LEP funding, it is likely that borrowing will be required to finance the future capital programme.

- 2.15 The capital programme includes an assessment of likely available resources to finance capital expenditure this is included at Appendix 2.

### **Property investment**

- 2.16 Lambert Smith Hampton (LSH) were commissioned by the Council in 2014 to undertake a strategic property review. The outcome of this process was reported to the March 2015 Cabinet which resulted in a number of decisions on the general aims of the Council, including establishing a Property Investment Board. The terms of reference include authority to agree a reinvestment programme and to determine the level of receipts to be recycled into new investments to support the Council's capital or revenue programme.
- 2.17 The Portfolio Holder for Property and Housing has delegated powers to agree to acquisitions and disposals up to £5,000,000 and the Deputy Managing Director/ Property Section Head have delegated powers to agree to acquisitions and disposals up to £3,000,000. Both of these subject to a full written business case being prepared and signed off by Finance and Legal and the acquisition/disposal being in line with the Property Investment Board Investment Strategy.
- 2.18 The LSH review identified that the property investment portfolio is unbalanced with an overloading of retail property. Re-profiling of the portfolio over time in accordance with a property investment strategy has been agreed by the Property Investment Board with some non-conforming properties being replaced by higher yielding conforming properties.

### **Other investments**

- 2.19 Watford Borough has established a commercial trading company Watford Commercial Services Ltd, of which it has 100% ownership. At present the only activity carried out through the company is Watford's investment in Hart Homes Development LLP, of which it has a 50% share. This is a joint venture with Watford Community Housing set up to deliver housing development within the area. In addition Watford Borough Council has a direct 50% share in Hart Homes (Watford) Ltd which was set up for the ongoing management of rental properties developed by Hart Homes Development LLP.
- 2.20 Watford Borough Council has set up a Local Asset Backed Vehicle (LABV) with Kier to develop Watford Health Campus. Under the LABV model, the public sector transfers land into to the partnership and the private sector matches the value of the asset to deliver the joint venture's objectives. Empowering the joint venture (by way of land and money) to deliver the regeneration and transformation activities agreed between the parties.
- 2.21 All investment activity in relation to other investments is managed through the capital programme and revenue budget process. The activity of the joint venture and

investments in partnerships and companies is included within the Group Accounts which are prepared as part of the Annual Statement of Accounts.

### ***Future Investment***

2.22 Future Investment Schemes will be assessed on the basis of a full business case which will include full resourcing for the project and an assessment of affordability. Priority areas for future capital investment are:

- ***Schemes through the joint ventures that generate a surplus and increase the supply of housing locally.***
- ***Schemes that generate revenue budget savings or income.***
- ***Schemes that allow the council to benefit from future economic regeneration potential within the local area.***

## **3. TREASURY MANAGEMENT**

3.1 The Council is required to operate a balanced budget over the medium term which, after allowing for contributions to and from reserves, broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing the requisite liquidity before considering investment return. The Council has purchased investment properties to improve the yield on its longer term surplus cash.

3.2 The Treasury Management Policy Statement, details the policies, practices, objectives and approaches to risk management of its treasury management activities, which is to be monitored by the Audit Committee. The Council's investment strategy's primary objectives are safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective. The strategy allows the Director of Finance, in consultation with the Portfolio Holder, the delegated authority to approve any variation to the Treasury Management Strategy during the year which may be brought about by investigating the opportunity to invest for greater than one year and also to invest in other investment instruments i.e Government bonds, Gilts and investment property with a view of maximising the Council's returns without significantly increasing risk.

### ***The Council's Borrowing Need - The Capital Financing Requirement (CFR)***

3.3 The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure, which has not immediately been paid for, will increase the CFR. An increase in the CFR does not necessarily mean that the council will borrow externally to fund the increase. The Council manages its cash balances as a whole and may choose to use internal cash

(generated by holding reserves and through timing differences between income and expenditure).

- 3.4 The table below shows the estimate of the CFR for 2019/20 and 2020/21 along with an analysis of forecast resources for 2021/22 and beyond.

	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Forecast	Estimate	Estimate	Estimate
	£M	£M	£M	£M	£M
Total Proposed Capex		29.2	58.1	53.8	32.4
Capital Financing -					
Grants		1.8	2	2	0
Reserves		1.5	0	0	0
Capital Receipts		12.3	9.8	11.3	6.3
s.106 and CIL		0.6	0.6	0.6	0.6
Closing CFR	<b>29.1</b>	<b>42.1</b>	<b>87.7</b>	<b>127.6</b>	<b>153.1</b>
Movement in the CFR*		13.0	45.7	39.9	25.5

At the end of 2017/18, the Council had no external borrowing, using the cash in its balance sheet arising from reserves to fund 'internal' borrowing. It is expected that this element of 'internal' borrowing will continue over the medium term.

#### **Minimum Revenue Provision (MRP) Strategy and Policy Statement**

- 3.5 The Minimum Revenue Provision (MRP) is designed to pay off an element of the capital spend which has not already been financed from existing revenue or capital I resources. The Council is required to make prudent provision, by way of a charge to the revenue account, which means that the repayment of debt is enabled over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.
- 3.6 The Council is also able to increase the rate it reduces its CFR by undertaking additional voluntary payments (voluntary revenue provision - VRP) in addition to any MRP; this is not currently the Council's policy.
- 3.7 Government Regulations require the Council to approve a MRP Statement in advance of each year. The following is Watford's MRP statement:

*For all unsupported borrowing (including PFI and finance leases) the MRP policy will be:*

- **Asset life method** – *MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3)*

*This option provides for a reduction in the borrowing need over the asset's estimated life.*

- 3.8 Watford Borough Council's process is to produce for approval by the Director of Finance, in consultation with the Portfolio Holder, a business case for each scheme intended to be unfunded from other resources. This will clearly show the level of MRP which is proposed to ensure that the repayment of any debt can be made in a period commensurate with the period over which the expenditure provides benefits or makes returns.
- 3.9 No MRP provision is made in respect of investments or payments in to Watford Commercial Services or the joint ventures as such investments are intended to be time-limited and allow for the repayment of debt. For finance leases the council will charge MRP to its General Fund each year dependant on the life of the underlying asset.

### **Revenue Cost of Borrowing**

- 3.10 Where the council decides to borrow to fund capital expenditure the annual cost of borrowing is included within the revenue budget.

### **Prudential Indicators**

- 3.11 There are two limits on external debt: the 'Operational Boundary' and the 'Authorised Limit'. Both are consistent with existing plans and the proposals in the budget report for capital expenditure and financing, and with approved treasury management policy statement and practices.
- 3.12 The first key control over the treasury activity is a Performance Indicator (PI) to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

#### Treasury Management Indicator - The Operational Boundary

- 3.13 This is the limit beyond which external borrowing is not normally expected to exceed. In most cases this would link directly to the authority's plans for capital expenditure, its estimates for CFR and its estimate of cashflow requirements for the year for all purposes. The Council may need to borrow, this limit represents a contingency should the need arise.

<b>Operational Boundary</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
Borrowing	£10M	£40M	£90M	£100M

## Treasury Management Indicator - The Authorised Limit for External Borrowing

3.14 This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which external long and short term borrowing is prohibited, and this limit needs to be set or revised by the Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (2) of the Local Government Act 2003.

Authorised Limit	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	£12M	£55M	£100M	£120M

## 4. Future Investments

4.1 The Council will continue to seek opportunities to work in partnership with others to promote economic development and the provision of housing within Watford's wider economic area. Current partners include Kier for the Watford Health Campus, along with Watford Community Housing as the main local registered social provider.

4.2 The council has established Watford Commercial Services to allow it to work more closely with providers and exploit future commercial opportunities. The Council currently has a joint venture with Watford Community Housing through Hart Homes Development LLP and Hart Homes Ltd.

## 5. Skills and Knowledge and Professional Advice

5.1 The Council has a shared service with Three Rivers District Council for the provision of the finance function allowing access to a greater range of professional skills than would otherwise be available if each council had a separate team.

5.2 Watford Borough Council uses Lambert Smith Hampton (LSH) to provide advice on and management of its investment property portfolio. LSH also provide ad-hoc advice where required on other projects. The Council has framework agreements in place with Grant Thornton to provide finance and accountancy advice and Trowers for legal advice. The council uses external advisers on all major projects.

5.3 The Council contracts with Link Asset Services for the provision of Treasury advice. Link Asset Services provide non-regulated advice on the management of the council's cash flows, investments and borrowings and a markets information service. The Councils VAT advisers are PSTax.



## **6. Risk**

- 6.1 Financial risks are closely monitored as a separately identifiable part of the corporate risk management framework. The Council's risk appetite is evolving as it becomes involved in a wider range of major property lead investments both within its economic area linked to regeneration and more widely for income generation purposes.
- 6.2 The Council takes advice from its professional advisers to both identify and mitigate the key risks it faces and ensures that all decisions are made with an understanding of the risks involved. The ongoing management of risk is a key function of the Council's Property Investment Board which routinely takes advice from LSH.
- 6.3 The council currently has an income target of £7.3M pa from its commercial investment activities. This is equivalent to 28% of its total gross income (excluding housing benefit reimbursements from government) of £26.3M in 2018/19. The Council does not receive RSG and is entirely dependent upon locally raised taxes and locally generated income to fund services. The general fund balance as at 1<sup>st</sup> April 2018 was £2M.
- 6.4 Whilst recognising the importance of generating income to support services, the Council will ensure that its external income is actively managed to safeguard the future financial sustainability of the council. In this respect it will continue to seek to balance income from its commercial investment activities against its overall level of risk and the amount of reserves available to mitigate this risk.
- 6.5 In assessing the risk of its commercial investments the Council will consider the level of risk inherent in the income stream, the security held, its ability to realise assets or other security should the need arise and the level of income received from commercial investments compared to the total income of the council.

## Capital Forecast

The capital forecast shows the forecast for the period of the current MTFS. New major schemes will be subject to individual business cases, including identification of resources and an assessment of affordability.

Capital	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	TOTAL £'000
MTFS Capital Programme	32,766	21,448	17,302	-	-	71,516
Re-phasing from 2017/18	7,547	-	-	-	-	7,547
<b>Approved Capital Programme as at June 2018</b>	<b>40,313</b>	<b>21,448</b>	<b>17,302</b>	<b>-</b>	<b>-</b>	<b>79,063</b>
Capital Programme Existing items changes	(694)	2,468	0	0	0	1,774
Capital Programme Proposed Changes	(10,468)	34,141	36,463	32,394	11,005	103,535
<b>TOTAL</b>	<b>29,151</b>	<b>58,057</b>	<b>53,765</b>	<b>32,394</b>	<b>11,005</b>	<b>184,372</b>

Capital Programme 2018-23	2018/19 Revised £000s	2019/20 Original £000s	2020/21 Original £000s	2021/22 Original £000s	2022/23 Original £000's
Community & Environmental	9,089	7,399	9,332	3,388	465
Democracy & Governance	2,881	11,876	782	400	400
Place Shaping & Performance	7,477	13,890	10,615	5,811	50
Service Transformation	433	1,311	530	530	530
Strategic Finance	677	979	679	681	682
Watford Riverwell	6,682	14,241	8,392	2,855	8,878
Property Investment Board	212	0	0	0	0
Hart Homes LLP	1,700	8,360	23,435	18,730	0
<b>Capital Investment Programme</b>	<b>29,151</b>	<b>58,057</b>	<b>53,765</b>	<b>32,395</b>	<b>11,005</b>
<b>Total Capital Investment Programme</b>			<b>184,373</b>		

## Capital Funding 2018-2021

<b>FUNDING</b>	<b>Forecast Outturn 2018/19 £m</b>	<b>Budget 2019/20 £m</b>	<b>Budget 2020/21 £m</b>	<b>Budget 2021/22 £m</b>	<b>Budget 2022/23 £m</b>
Grants and Contributions	1.8	2.0	2.0	0.0	0.0
Use of Capital Reserves	1.5	0.0	0.0	0.0	0.0
Use of Capital receipts	12.3	9.8	11.3	6.3	0.9
S106 and CIL contributions	0.6	0.6	0.6	0.6	0.6
Borrowing - internal and external	11.8	44.3	38.5	26.0	10.1
<b>TOTAL CAPITAL FUNDING APPLIED</b>	<b>29.2</b>	<b>58.1</b>	<b>53.8</b>	<b>32.3</b>	<b>11.0</b>

# Treasury Management Policy

## 2019/20



## Summary

- 1.1. The purpose of this report is to set out the Council's Treasury Management Policy
- 1.2. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".
- 1.3. This report supports the Council's Capital Strategy and provides additional detail on how the Council manages its Treasury Management Activity
- 1.4. The Treasury Management Policy details the policies, practices, objectives and approaches to risk management of its treasury management activities, which is to be monitored by the Audit Committee. The Council's investment policy's primary objectives are safeguarding the repayment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective. The policy allows the Portfolio Holder, in consultation with the Director of Finance, the delegated authority to approve any variation to the Treasury Management Policy during the year with the objective of maximising the Council's returns without significantly increasing risk.

## 2. Risks

- 2.1. The strategy details the approach taken to management of Treasury Risk. This is principally through ensuring that the main Treasury risks are managed. These risks are:

liquidity risk – that the Council may not have the cash it needs on a day to day basis to pay its bills. This risk is managed through forecasting and the retention by the Council of an adequate working capital balance. In addition, through the Public Works Loan Board and other organisations, the Council is able to access short term borrowing, usually within 24 hours.

interest rate risk – that the costs and benefits expected do not materialise due to changes in interest rates. This risk is managed through the placing of different types and maturities of investments, the forecasting and monitoring of the interest budget (with assistance from the Council's retained advisors).

exchange rate risk – that losses or gains are made due to fluctuations in the prices of currency. The Council does not engage in any significant non-sterling transactions.

credit and counterparty risk – that the entity holding Council funds is unable to repay them when due. This risk is managed through the maintenance of a list of authorised counterparties, with separate limits to ensure that the exposure to this risk is limited

refinancing risk – that the loans taken by the Council will become due for repayment and need replacing at a time when there is limited finance available or interest rates are significantly higher. The timing of loan maturities is monitored along with interest rate forecasts. Officers ensure that due dates are monitored and seek advice from the Council's advisors about when to raise any finance needed.

legal and regulatory risk – that the Council operates outside its legal powers. This risk is managed through the Council's training and development of Officers involved in Treasury Management, the independent oversight of Internal and External Audit,

and the advice (for example on the contents of this strategy) taken from the Council's Treasury advisors.

fraud, error and corruption – that risk that losses will be caused by impropriety or incompetence is managed through the controls in the Council's financial procedures. For example, the segregation of duties between those making investment decisions and those transferring funds

market risk – that the price of investments held fluctuates, principally in secondary markets. The majority of the Council's investments are not traded, but where they are (e.g. Property investment portfolio) the main investments' value comes from the income they generate which is generally long term and secure.

### 3. Treasury Indicators: Limits to Borrowing Activity

- 3.1. There are two limits on external debt: the 'Operational Boundary' and the 'Authorised Limit'. Both are consistent with existing plans and the proposals in the budget report for capital expenditure and financing, and with approved treasury management policy statement and practices.
- 3.2. The key difference is that the Authorised Limit cannot be breached without prior approval of the Council. The Operational Boundary is a more realistic indicator of the likely position. The difference between the authorised limit and operational boundary for borrowing is that the authorised limit includes a head room for borrowing for future known capital needs now. The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be revised if necessary by members.
- 3.3. These indicators are set out in the Capital Strategy.

### 4. Borrowing Strategy

- 4.1. The Council's treasury team maintains a cashflow forecast and works its liquidity requirements within this forecast; it may, on rare occasions, be necessary to borrow short-term for cashflow purposes. This will be in the form of short term debt or overdraft facilities and is normally for small amounts for minimum durations. As this is based on need and has a defined repayment period it is not normally included within the limits set above.
- 4.2. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated (ie: the cost of holding does not outweigh the benefits of early borrowing) and that the Council can ensure the security of such funds. Any associated risks will be approved and reported through the standard reporting method.

### 5. Investment Policy

- 5.1. The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are security first, liquidity second, then yield.
- 5.2. Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Schedules and are detailed at Annex A.

5.3. As part of its diversification of investments, the Council has invested some of its core funds (ie: funds not immediately required for cashflow reasons) in longer-term investment property instruments. These are in the form of individual assets directly owned by the council. Although the Council has no current investments or plans to invest in pooled property funds, these are an option that could be considered in the future. All property investments are controlled through the Property Investment Board (PIB) and each investment is subject to its own business case and appraisal before a decision to invest is taken and before any Council funds are committed.

## 6. Creditworthiness policy

### 6.1. The Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

6.2. The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary and will provide an overall pool of counterparties considered high quality.

6.3. Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

## 7. Counterparty Categories

7.1. The Council uses the following criteria in choosing the categories of institutions in which to invest:

- **Banks 1 - Good Credit Quality**

The Council will only use UK banks or foreign banks trading in the UK in sterling denomination and which meet the Rating criteria.

- **Banks 2 – The Council's Own Banker**

For transactional purposes, if the bank falls below the above criteria, it will be included, although in this case balances will be minimised as far as possible in both monetary size and time within operational constraints.

- **Bank Subsidiary and Treasury Operations**

The Council will use these where the parent bank has the necessary ratings outlined above and the parent has provided an indemnity guarantee.

- **Building Societies**

The Council will use all Societies which meet the ratings for banks outlined above.

- Specific Public Bodies

The Council may lend to Public Bodies other than Local Authorities. The criterion for lending to these bodies is that the loan has been approved by Council.

- Money Market Funds AAA Rated

The Council may lend to Money Market Funds in order to spread its investment risk.

- Local Authorities

A limit of £5m per authority will be applied.

- Debt Management Deposit Account Facility

A Government body which accepts local authority deposits.

- Council Subsidiaries (non-specified)

The Council will lend to its subsidiaries subject to approval of a business case by the Portfolio Holder, in consultation with the Director of Finance. Business cases must be accompanied by an independent assessment of viability, and be subjected to regular monitoring by the Director of Finance.

7.2. For details of Specified and Non-Specified Investments see below.

## 8. Use of Additional Information Other Than Credit Ratings

8.1. Additional requirements under the Code of Practice require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

## 9. Time and Monetary Limits Applying to Investments

9.1. The time and monetary limits for institutions on the Council's Counterparty List summarised in the table below, are driven by the above criteria. These limits will cover both Specified and Non-Specified Investments.

## 10. Exceptional Circumstances

10.1. The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions Director of Finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly, the time periods for investments will be restricted.

10.2. Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMO) – a Government body which accepts local authority



deposits, money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

## 11. Investment Strategy

- 11.1. In-House Funds - investments will be made with reference to the core balance and cashflow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
- 11.2. Investment Treasury Indicator and Limit - total principal funds invested for greater than one year. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Treasury Indicator & Limit	2018/19	2019/20	2020/21
Maximum Principal Sums invested for greater than one year (excluding property investment and loans to Council subsidiaries).	£5m	£5m	£5m

## 12. Investment Risk & Security Benchmarking

12.1. These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmarks is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report. In line with the Treasury Management Strategy, the Council has managed to invest with those institutions who offered the best rate and the investment portfolio is above the overall benchmark during the year to date.

### Security

12.2. Security of the investments is measured by credit ratings, which is supplied by the three main credit rating agencies (Fitch, Moodys and Standard & Poors). Where investments are made to Council subsidiaries (non-listed), the security is measured through a business case with independent viability assessment.

### Liquidity

12.3. The Council set liquidity facilities/benchmarks to maintain:

- Authorised bank overdraft - nil.
- Liquid short term deposits of at least £5m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 10 years for an individual loan with a public body (excluding loans to institutions the Council has an interest in).

12.4. The Council has the benefit of instant access to its funds on the general account with Lloyds.

Yield

12.5. The measure of yield on Investments is a return of 0.12% above average bank rate. In accordance with the Code of Practice on Treasury Management this used as a performance indicator. The results of this indicator have been reported in the Treasury Annual Report and the mid-year report.

### 13. Reporting Requirements

13.1. End of Year Investment Report - the Council will report on its investment activity for the financial year completed as part of its Annual Treasury Management Report after the end of the financial year.

13.2. Mid-year Investment Report – the Council will report on its investment activity for that financial year as part of its Mid Year Treasury Management Report at the end of September of that financial year.

13.3. Capital Strategy – the Council will produce the Strategy for the next three financial years towards the end of the current financial year.

### 14. Policy on the Use of External Service Providers

14.1. The contract for external treasury management advisors was re-tendered in October 2016, and following this, Capita Asset Services Treasury Solutions (now Link Asset Services) have been appointed as the advisors to the Council until October 2019. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

14.2. The Council will also, from time to time, procure specialist advice for ad-hoc pieces of work; this will be procured in accordance with the Council's normal procedure rules.

### 15. Member and Officer Training

15.1. The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by:

- Ensuring that officers attend suitable courses and seminars to keep their technical knowledge up to date;
- Keeping up to date with CIPFA publications on Treasury Management. From December 2017 there are new codes for Capital Finance in Local Authorities and also a new Treasury Management Code;
- Regular briefings both by email and face to face with the Council's Treasury advisors;
- Reports and briefing sessions to Members on major changes to Treasury policies and strategies.

## Annual Investment Strategy

The investment policy for the Council is:

Strategy Guidelines – the main strategy guidelines are contained in the body of the Capital Strategy and Treasury Management Policy

Specified Investments – these investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments with:

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- A local authority, parish council or community council.
- A body that is considered of a high credit quality (such as a bank or building society) with a minimum short term rating of F-1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies or a Building Society with assets over £1,000m. Non rated Building Societies are non-specified investments.
- Money Market Funds (triple AAA rated only).

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are defined in the Treasury Management Strategy.

The ratings criteria and exposure limits are detailed at Schedule 1.

Non-Specified Investments – non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

Non Specified Investment Category	Limit (£ or %)
Any bank or building society that has a minimum long term credit rating of A (or equivalent), for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£5m
The Council's own banker if it fails to meet the basic credit criteria.	In this instance balances will be minimised as much as possible
Building Societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a	£2m

<p>credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £5,000m, but will restrict these types of investments to £2m for up to six months.</p>	
<p><b>Specific Public Bodies</b></p> <p>The Council can seek Member approval to make loans to other public bodies for periods of more than one year.</p>	£10m
<p><b>Loans to Council Subsidiaries</b></p> <p>The Council will lend to its subsidiaries subject to approval of a business case by the Portfolio Holder, in consultation with the Director of Finance. Business cases must be accompanied by an independent assessment of viability, and be subjected to regular monitoring by the Director of Finance.</p>	£10m limit for any single loan
<p><b>Other unspecified investments</b></p> <p>The strategy allows the Portfolio Holder, in consultation with the Director of Finance, in consultation with the Lead Member, the delegated authority to approve any variation to the Treasury Management Strategy during the year which may be brought about by investigating the opportunity to invest for greater than one year and also to invest in other investment instruments i.e Government bonds, Gilts and investment property with a view of to maximising the Council's returns without significantly increasing risk. This allows the addition of further unspecified investments, subject to conditions which will be generally similar to (e).</p>	£10m

The Council will also consider investment in property in accordance with its Property Investment Strategy. All property investments will be dependent on a standalone business case being proven.

#### The Monitoring of Investment Counterparties

The credit rating of counterparties is monitored regularly. The main rating agencies (Fitch, Moody's and Standard & Poor's) provide credit ratings for financial institutions. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services Treasury Solutions as and when ratings change, and counterparties are checked promptly. The Council considers minimum short term ratings as key criteria in the choice of creditworthy investment counterparties; F1+, P-1 and A-1+ are the highest short term credit ratings of Fitch, Moody's and Standard & Poor's respectively. Minimum Short Term Ratings, where given, must be met for all categories. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the

Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

For non-specified investments (e.g. e-f above) the progress of the entity against the approved, independently verified business case will be monitored by the Director of Finance.

Institution Type	Max Amount:			£10m	£10m	£10m	£10m	£10m	Schedule 1
	Max Length:			10 Years	364 Days	6 Months	3 Months	1 Month	
	Minimum Short Term Ratings								
	Fitch	Moody's	S&P						
UK Banks									
The Council's own Bankers	F1m	P-1	A-1	If Council's own bankers fall below the minimum long term criteria for UK banks, cash balances will be managed within operational liquidity constraints and balances will be minimised as much as possible.					
Wholly Owned Subsidiaries of UK Clearing Banks - Parent Ratings	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating	
Partially Owned Subsidiaries of UK Clearing Banks - Parent Ratings	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating	

UK Building Societies								
Either	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating
Or					Assets over £15,000m	Assets over £5,000m	Assets of £2,500m	Assets of £1,000m
Specific Public Bodies				As approved by Members				
Debt Management Deposit Facility (UK Government)						Unlimited		
Money Market Funds (AAA Rated)								£5m per fund
Municipal Bond Agency				As approved by Members				
UK Local Authorities				The Council can invest in all UK Local Authorities whether rated or not				

Notes:-

1. F1+, P-1 and A-1+ are the highest short term credit ratings of Fitch, Moody's and Standard and Poor's respectively.
2. Minimum Short Term Ratings - Where given, these must be met, for all categories (except RBS Group).
3. Building Societies - A Building Society has to meet either the ratings criteria or the assets criterion to be included in the category, not both.
4. Maximum amount is the maximum, in total, over all investments, with any one institution (with the exception of RBS Group).



## **PROPERTY INVESTMENT STRATEGY**

### **Property Investment Policy**

The council is restricted in the different investment vehicles it is legally allowed to invest in notwithstanding the over-riding need for prudence. Of the few options open one is Property and the returns from investing in property have generally been, and currently are, greater than the limited opportunities in the money markets. This should be read in conjunction with the Asset Management Policy.

In broad terms the returns can be higher because the risks are greater. Factors to be taken into account when deciding the principle of investing in property include:

- investment will be for the long term since it may not be possible, or wise, to sell quickly
- the costs of acquisition and disposal
- there are management costs, risk of rent default and failure to honour maintenance agreements
- generally property tends to appreciate in value, although this will vary by type and area; however, in some cases the value may go down
- property can become functionally obsolete necessitating major refurbishment
- without regular repair and maintenance the condition will deteriorate and the responsibility for repairs/maintenance may not always rest with the tenant
- certain types of property may become less desirable as time goes by; this can make re-letting difficult or attract a lower calibre of tenant.

### **How much is invested?**

Approximately £100 million is currently held in the property portfolio and £ 30 million is invested in treasury investments (short term investments (less than 1 year) with UK building societies and banks).

### **What type of property?**

There are different types of property investment as follows:

- Retail
- Office
- Industrial
- Leisure

For risk management purposes it is recommended that no single asset should comprise more than 10% of the whole portfolio and locations should be diverse as should property types. Convention has often dictated an ideal balance of 30% of monies invested in each retail, office and industrial sectors, and the remaining 10% into leisure and miscellaneous uses. The mix helps to protect the fund against movements that might adversely affect one specific sector which would otherwise have a disproportionate impact.

### **What level of financial return?**

In general, property can be categorised as prime, secondary or tertiary in terms of its desirability. 'Rack-rented' means that the maximum market rental achievable is being received. Yield derives from both capital and rent. Lower yields can indicate that the investment attracts a lower degree of risk due to the ratio of rent to capital and other factors such as location, security and regularity of income.

Property investment returns will differ depending upon the market and the nature of the asset.

The Investment Portfolio Database (IPD) index tracks total returns (income return and capital growth) on a combined portfolio of all property types and is frequently used as a benchmark by which to measure the performance of individual portfolios. Over the last 12 months the Index has demonstrated All Property returns of 16.2%, comprised of retail at 10.6%, office at 21.3%, and industrial at 20.7%. The long term average total return is 8.3%, which would be a more reliable benchmark moving forward.

The Council has a target to grow the income from the portfolio by 5% per annum. This is to be benchmarked against the income return element of the IPD Index to demonstrate that value for money has been achieved and to promote accountability.

### **Where should it be located?**

Within the UK the location will influence the return and the type of property and may make management more or less difficult depending on distance from the Council offices. Only property located in the UK will be considered.

Wherever possible, stock to be selected should support local regeneration and provide a community benefit, although the Council may have to consider opportunities outside the Borough in order to achieve the required results.

## INVESTMENT PORTFOLIO ASSESSMENT MATRIX

A scoring matrix allows the relative merits of an investment opportunity to be measured. The resultant score can then be assessed against a target measure or used for comparison against other opportunities. The key financial elements are covered in the following table:

SCORING CRITERIA	Score	4	3	2	1
	Weighting Factor	Excellent / Very Good	Good	Acceptable	Not Acceptable
Location	5	Major prime	Micro prime	Secondary	Tertiary
Tenant Covenant	5	Single tenant with strong financial covenant	Multiple tenants with strong financial covenant	Single or Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Building Quality	4	Modern or recently refurbished with nominal capex required	Good quality with capex likely to be required within the next 20 years	Good quality with capex likely to be required within the next 10 years	Older style or non-compliant with capex required within the next 5 years
Occupier's Lease Length	4	Greater than 10 years	Between 6 and 10 years	Between 3 and 6 years	Less than 3 years or vacant
Tenure	3	Freehold	Lease 125 years plus	Lease between 100 and 125 years	Lease between 60 and 100 years
Lot Size	3	Between £3m & £5m	Between £2m & £3m or £5m & £7m	Between £1m & £2m or £7m & £10m	Greater than £15m
Max Score		96	72	48	24

The threshold score should be set at 60.