Attachment 3

Watford Borough Council

Capital Strategy

2022/23

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 it 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. It is supported by the following policies which are included as appendices to the strategy:

Appendix 1: Treasury Management Policy
Appendix 2: Property Investment Strategy
Appendix 3: Minimum Revenue Provision Policy

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,
- investment properties, and
- loans to subsidiaries and joint ventures.

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 does not capitalise borrowing costs for assets under construction with the exception of development in relation to its commercial portfolio. The council has a number of joint ventures for development where borrowing costs in relation to assets under construction are routinely capitalised and repaid from the proceeds of sale.

2.6 Detailed accounting policies in relation to assets and capital expenditure may be found in the annual statement of accounts.

2.7 A summary of the proposed capital programme is set in the table below. New major schemes will be subject to individual business cases, including identification of resources and an assessment of affordability. A detailed breakdown of the Capital Programme is set out in Appendix 6 of Attachment 1 to the Budget Report and reported on a quarterly basis to Cabinet.

Service Area	**Revised Budget 2021/22 £000**	**Draft Budget 2022/23 £000**	**Draft Budget 2023/24 £000**	**Draft Budget 2024/25 £000**	**Total Investment £000**
Service Transformation	9,128	2,881	1,110	780	13,899
Community & Environmental	18,548	2,202	1,731	1,667	24,149
Place Shaping	40,102	62,808	10,262	1,823	17
Strategic Finance	681	682	677	677	2,716
Corporate Strategy and Comms	526	-	-	-	526
Total Capital Investment Programme	**68,984**	**68,573**	**13,780**	**4,947**	**156,284**

Capital Investment Programme - Funding

2.8 The Capital Investment Programme can be funded from the following sources:

2.9 <u>Government Grants & Other Contributions:</u> 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 <u>Section 106 Contributions:</u> 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 <u>Capital Receipts:</u> 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.

2.15 The capital programme includes an assessment of likely available resources to finance capital expenditure. The funding for the latest capital programme is set out in the table below:

FUNDING TYPE	Revised Budget 2021/22 £000's	Draft Budget 2022/23 £000's	Draft Budget 2023/24 £000's	Draft Budget 2024/25 £000's
Grants & Contributions	7,541	3,805	0	0
Reserves	244	0	0	0
Capital Receipts (PIB & non PIB)	7,875	9,773	0	0
Section 106 & CIL Contributions	22	0	0	0
Local Enterprise Partnership Loan	0	1,250	0	0
Borrowing (Internal & External)	53,303	53,745	13,780	4,947
TOTAL CAPITAL FUNDING APPLIED	**68,984**	**68,573**	**13,780**	**4,947**

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.

2.17 The overarching Property Investment Strategy is included at Appendix 2. The strategy objectives have been updated to reflect the latest PWLB lending terms and conditions (revised November 2020) and PWLB Guidance (issued August 2021). The primary aim of the revision to the terms and conditions was to prevent the use of PWLB borrowing to finance investments made on a debt for yield basis; specifically the purchase of investment assets. Access to the PWLB will be restricted for authorities planning to acquire investment assets in the current or following three years, including active portfolio management where the acquisition of a new asset is funded by the sale of an existing asset. However, the Prudential Code for Capital Finance confirms that authorities with commercial property may continue to invest in the repair, renewal and updating of their existing commercial properties. Authorities can also continue to invest in regeneration projects within their local area.

2.18 The Portfolio Holder for Property and Housing has delegated powers to agree to acquisitions and disposals up to £5,000,000 and the Head of Place Shaping/ 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.

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) (the Watford Health Campus Partnership LLP) 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 In July 2019, the Council acquired Croxley Park (a local business park) by way of a finance lease. Both the asset and lease liability are recognised on the Council's balance sheet. Because of the size of the finance lease, this is shown separately within the Council's authorised limit and operational boundary for borrowing.

2.22 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

2.23 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 for Resources, 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 actual CFR for 2020/21 (subject to conclusion of audit of Statement of Accounts for 2020/21) and estimate for 2021/22 along with an analysis of forecast resources for 2022/23 and across the MTFS. The Council is asked to approve the CFR projections below:

	2020/21 Actual £m	**2021/22 Forecast £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
CFR relating to Capital programme					
Opening CFR		50.525	101.648	154.464	165.714
Proposed Capital Expenditure		68.984	68.573	13.780	4.947
Capital Financing:					
Grants		(7.541)	(3.805)	0.000	0.000
Reserves		(0.244)	0.000	0.000	0.000
Capital Receipts		(7.875)	(9.773)	0.000	0.000
Section 106 and CIL		(0.022)	0.000	0.000	0.000
Total Financing		(15.682)	(13.578)	0.000	0.000
MRP		(0.179)	(0.179)	(0.530)	(0.530)
Repayment of loans from JVs		(2.000)	(2.000)	(2.000)	(2.000)
Closing CFR relating to Capital programme	**50.525**	**101.648**	**154.464**	**165.714**	**168.131**
CFR relating to Croxley Park Finance Lease					
Opening CFR		232.942	228.994	225.046	221.098
MRP on Finance Lease		(3.948)	(3.948)	(3.948)	(3.948)
Closing CFR relating to Finance Lease	**232.942**	**228.994**	**225.046**	**221.098**	**217.150**
Total Opening CFR		**283.467**	**330.642**	**379.510**	**386.812**
Total Closing CFR	**283.467**	**330.642**	**379.510**	**386.812**	**385.281**
Movement in the CFR		47.175	48.868	7.302	(1.531)

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 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. Watford's MRP policy statement is at Appendix 3.

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

Prudential Indicators

3.10 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.

3.11 These prudential indicators 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 2021/22 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

3.12 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.

Operational Boundary	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing - Capital Programme	135.000	158.000	168.000	170.000
Finance Lease – Croxley Park	230.000	226.000	222.000	218.000
Total	365.000	384.000	390.000	388.000

Treasury Management Indicator - The Authorised Limit for External Borrowing

3.13 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	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	150.000	170.000	180.000	180.000
Finance Lease – Croxley Park	235.000	231.000	227.000	223.000
Total	377.000	401.000	407.000	403.000

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 Riverwell project, 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.

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. It also uses CTI as adviser on Croxley Park. The Council has a framework agreement in place with Grant Thornton to provide finance and accountancy advice and has used Trowers for legal advice on the acquisition of Croxley Park. 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 £12.668 million pa from its commercial investment activities, including £1.500 million net income from Croxley Park (all other monies are ring-fenced within the scheme). This is equivalent to 34% of its total gross income (excluding housing benefit reimbursements from government). 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 April 2021 was £2.000 million.

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.

Treasury Management Policy

2022/23

1. Overview

1.1 This document sets 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 The Treasury Management Policy supports the delivery of 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 primary objectives are of the Treasury Management Policy are:

- Security - Safeguard the repayment of the principal and interest of its investments on time
- Liquidity - Ensure adequate liquidity to meet obligations as they fall due
- Yield - Investment return is the final objective and is considered after security and liquidity requirement have been satisfied.

1.5 This policy is reviewed and approved annually by Council alongside the Council's budget, Medium Term Financial Strategy (MTFS) and Capital Strategy.

1.6 The Director of Finance in consultation with the Portfolio Holder Resources has 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 key Treasury Management risks are set out in the CIPFA Treasury Management Code of Practice ("the TM Code"). The following paragraphs set out these risks and how they are managed:

Liquidity Risk - 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 - 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, within limits set for the amount of borrowing which may mature in a given time-period, the forecasting and monitoring of the interest budget (with assistance from the Council's retained advisors).

Exchange Rate Risk - 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 - 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 - 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 - 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 - the risk that losses will be caused by impropriety or incompetence.

This 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 - 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. These indicators are set out in the Capital Strategy.

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 In addition to the limits controlling the total amount of borrowing, further limits are in place to control the Council's exposure to interest rate risk on refinancing. These limits are set out in the following table:

Maturity Structure of Borrowing		
	Lower	Upper
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	50%
10 years to 20 years	0%	50%
20 years to 30 years	0%	50%
30 years to 40 years	0%	50%
40 years to 50 years	0%	50%

3.4 These limits range between 0% and 100% for loans out to 5 years where there is some degree of accuracy with the forecasts for interest rates. Then for the longer term, loans are limited to 50% of the overall borrowing portfolio maturing in each of the given timeframes. The 50% maximum limit protects the Council from being exposed to high levels of refinancing when interest rates may be substantially higher than they are now. Borrowing is expected to increase in following the strategy set out in the following paragraphs

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 (i.e. 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.

4.3 The Council's level of external borrowing is expected to increase across the period of the MTFS. In recent years the Council has followed a policy of using internal borrowing – which is the use of the Council's own short-term cash surpluses (which back the Council's reserves and provisions) – to limit the interest cost of financing borrowing-funded elements of the Capital Programme. The Council's capacity to use internal borrowing is now diminished and external borrowing will be required to finance future spend. In the longer-term it will also be necessary to refinance internal borrowing with external debt.

4.4 Interest rates on short-duration loans are significantly lower than on longer term debt. Interest rates are expected to remain at these very low levels for some time to come. In order to benefit from these lower short-term rates, it is proposed that the Council will manage long-term financing by building a portfolio of short-term (0-5 year duration) loans, the timing of which will be determined by the cash need to borrow.

4.5 Short-term debt will be replaced by longer term (10+ year duration) loans, based on projections for CFR, ensuring that financing cost will be spread over the useful life of the assets being financed.

4.6 Officers will monitor interest rate forecasts, and in conjunction with Treasury Management advisors determine the optimum timing and amount of future borrowing.

5. Investment Policy

5.1 The Council's investment policy has regard to the Statutory Guidance on Local Government Investments and the 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 and counter-party limits are listed in Annex A under the 'Specified' and 'Non-Specified' Investments categories.

5.3 As part of its diversification of investments, the Council has invested some of its core funds (i.e. 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. 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.

5.4 Although the Council has no current investments or plans to invest in pooled property funds, these are permitted under the policy and are an option that could be considered in the future

5.5 The Council received a £92m reserve as a result of its acquisition of Croxley Park. These funds will be required over the life of the asset to cover any shortfalls in rental income (voids) and to cover the cost of planned programmed maintenance and refurbishment.

5.6 Following a competitive appointment process supported by the Councils Treasury Advisers, this cash has now been invested in three funds managed by Royal London Asset Management.

5.7 These investments are governed by the Councils Treasury Management policy, but are to be considered separately from the Council's operational cash. The performance of these investments will be reported separately to the Commercial Income Board.

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 schedule at Annex A.
- 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 in section 7. The criteria will be reviewed regularly and proposed changes will be submitted to Council for approval as necessary in order to 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 Director of Finance in consultation with the Portfolio Holder for Resources. 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 Annex A.

8. Use of Additional Information Other Than Credit Ratings

8.1 Additional requirements under the TM Code 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 at paragraph 11.2, are driven by the criteria set out in sections 7 and 8. 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 Office Account Deposit Facility (DMADF) – 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. Negative Interest Rates

11.1 In March 2020, the Bank of England (BoE) lowered the base rate to an historic low level of 0.10%. The low base-rate has resulted in very low returns on short-term investments including negative interest rates on high credit quality deposits such as the DMADF. Inflation is above the BoE target of 2% making the possibility of an interest rate increase more likely. However, there remains a possibility that the bank could still move to set an interest rate below 0% as a measure to provide further economic stimulus to manage the long-term economic impact of the COVID-19 pandemic, which would likely feed through to negative rates on all low-risk short-term investment options.

11.2 In the event of negative interest rates, security would be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

12. Investment Strategy

12.1 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).

12.2 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. The table below provides details of these limits.

Treasury Indicator & Limit	2022/23 £000	2023/24 £000	2024/25 £000
Maximum amount invested for periods over one year (Excludes Croxley Park Reserve, property investment and loans to Council subsidiaries).	£5m	£5m	£5m
Maximum amount invested for periods over one year. (Money Market Funds – Croxley Park Reserve)	£120m	£120m	£120m

13. Investment Risk & Security Benchmarking

13.1 The Council sets benchmarks for security, liquidity and yield. 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. The benchmarks are as follows:

Security:
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:
The Council sets the following liquidity facilities/benchmarks to maintain:

- Authorised bank overdraft - nil.
- Liquid short term deposits of at least £1.0m available with a week's notice.

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

Yield:
The Council benchmarks the yield on its operational cash against SONIA (the Sterling Overnight Index Average). This is a measure of market rates for actual returns on overnight cash deposits. Performance against this indicator is monitored throughout the year.

14. Reporting Requirements

14.1 The Audit Committee has the responsibility for the scrutiny of Treasury Management policies and practices and receives the Treasury Management Policy for review prior to approval by Council.

An annual report on the performance of the Treasury Management function, including the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's treasury management policy is considered by Council following the end of the financial year.

14.2 Council also receives a Mid-Year Treasury Management Report setting out activity to 30 September.

15. Policy on the Use of External Service Providers

15.1 The contract for external treasury management advisors is carried out by Link Asset Services. 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.

15.2 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.

16. Member and Officer Training

16.1 In order to ensure that Members and Officers are sufficiently trained and qualified to monitor and manage the Council's Treasury Management activity, the following measures are in place:

- 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.
- 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.

Annex A

Schedule of Specified and Non-Specified Investments

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 on the following page.

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 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.	£2m
Specific Public Bodies The Council can seek Member approval to make loans to other public bodies for periods of more than one year.	£10m
Loans to Council Subsidiaries The Council will lend to its subsidiaries subject to approval of a business case by the Director of Finance in consultation with the Portfolio Holder (Resources). Business cases must be accompanied by an independent assessment of viability, and be subjected to regular monitoring by the Director of Finance.	£10m limit for any single loan
Money Market Funds Appointed through competitive process for the investment of the Croxley Park Reserve	£100m
Other unspecified investments The strategy allows the Director of Finance, in consultation with the Portfolio Holder (Resources), 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).	£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 Link Asset Services 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 inte1.1 rest. 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.

	Minimum Short Term Ratings			Schedule 1 (A) – UK BANKS			
Institution	**Fitch**	**Moody's**	**S&P**				
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	Long Term Credit Rating: AA(F), Aa2(M), AA(S&P)	Long Term Credit Rating: Single A (All agencies)	Long Term Crediting Rating: Lower than A (All Agencies)	Long Term Crediting Rating: Lower than A
Partially Owned Subsidiaries of UK Clearing Banks Parent Ratings	F1	P-1	A-1	Long Term credit Rating: AA(F), Aa2(M), AA(S&P)	Long Term Crediting Rating: Single A (All agencies)	Long Term Credit Rating: Lower than A (All Agencies)	Long Term Credit Rating: Lower than A
	Max Amount / Length:			**£10m** **364 Days**	**£10m** **6 Months**	**£10m** **3 Months**	**£10m** **1 Month**

	Minimum Short Term Ratings			Schedule 1 (B) – Building Societies			
Institution	Fitch	Moody's	S&P				
Building Societies – By Credit Rating	F1	P-1	A-1	Long Term Credit Rating: AA(F), Aa2(M), AA(S&P)	Long Term Credit Rating: Single A (all agencies)	Long Term CreditRating: Lower than A (All Agencies)	Long Term Crediting Rating: Lower than A
Building Societies – by Total Assets				Assets over £15bn	Assets over £5bn	Assets of £2.5bn	Assets of £1bn
	Max Amount / Length:			**£10m** **364 Days**	**£10m** **6 Months**	**£10m** **3 Months**	**£10m** **1 Month**

Schedule 1 (C) – Other Entities	
1. Specific Public Bodies	As approved by Members – up to £10m for up to 10 years
2. Debt Management Deposit Facility (UK Government)	Unlimited – this is the Council's Safe-Haven Deposit facility with the UK Government
3. Money Market Funds (AAA Rated) – excluding Croxley Park Reserve	£5m per fund
4. Municipal Bond Agency	As approved by Members
5. UK Local Authorities	A Maximum of £5m Applies per Authority. The Council can invest in all UK Local Authorities whether rated or not. The Council will not lend to an authority which is subject to a s.114 notice *without member approval.*

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).

Appendix 2

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 £200 million is currently held in the property portfolio.

What type of property?

There are different types of property investment as follows:

- Retail
- Office
- Industrial
- Residential
- Alternatives including 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. The mix helps to protect the fund against movements that might adversely affect one specific sector which would otherwise have a disproportionate impact.

The current target mix for the portfolio is as follows:

• Retail	25%
• Office	25%
• Industrial	35%
• Residential	10%
• Alternatives including Leisure	5%

Objectives

- Maintain income levels within the core portfolio, enhancing where possible without impacting on future income potential.
- Preserve, and where possible increase, the capital value of the portfolio but not at the expense of losing income
- Maintain, and where possible improve the net rental position for Croxley Park as detailed in line with the original purchase objectives
- Rebalance the portfolio by reducing the historic weighting towards Retail and Indirect investments
- Continue to match performance statistics provided by MSCI.
- Implement a capital expenditure programme and work with tenants to ensure that all assets meet the new Minimum Energy Efficiency Standards (MEES) regulations.
- Target and identify opportunities that meet the Councils sustainability and regeneration objectives
- Consider investment in the residential / PRS sectors through existing land holdings using an appropriate vehicle

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.

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
Score	Weighting Factor	Excellent / Very Good	Good	Acceptable	Not Acceptable
5	Location	Major prime	Micro prime	Secondary	Tertiary
5	Tenant Covenant	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
4	Building Quality	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
4	Occupier s Lease Length	Greater than 10 years	Between 6 and 10 years	Between 3 and 6 years	Less than 3 years or vacant
3	Tenure	Freehold	Lease 125 years plus	Lease between 100 and 125 years	Lease between 60 and 100 years
3	Lot Size	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.

Appendix 3

Minimum revenue provision (MRP) policy statement for 2022/23

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DLUHC regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP*:*

From 1 April 2008 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 approximately the asset's life.

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.