Council

8 February 2021

Treasury Management Strategy and Investment Strategy

Recommendations

That:

1. The Treasury Management Strategy for 2021/22 (Appendix 2) be approved with effect from 1st April 2021.

2. The Investment Strategy for 2021/22 (Appendix 3) be approved with effect from 1 April 2021.

3. The County Council requires the Strategic Director for Resources to ensure that gross borrowing does not exceed the prudential level specified (Appendix 2,Section 3.2, Table 10 “Authorised Borrowing Limit”).

4. The County Council requires the Strategic Director for Resources to ensure that gross investment in non-Treasury investments does not exceed the prudential levels specified (Appendix 3, Annex 7).

5. The County Council delegate authority to the Strategic Director for Resources to undertake delegated responsibilities in respect of both strategies (Appendix 2, Annex 7, and Appendix 3, Section 2.5).

6. The County Council requires the Strategic Director for Resources to implement the Minimum Revenue Provision (MRP) Policy (Appendix 2, Section 2.4).

1 Executive Summary

1.1 The Council is required to set a Treasury Management Strategy and Investment Strategy each year and these are set out at Appendix 2 and Appendix 3.

1.2 The Treasury Management Strategy, Investment Strategy, and Capital Strategy are all related. The features of these three strategies are summarised below, and the interrelationships are detailed in Appendix 1.

Capital Strategy	Treasury Management strategy	Investment strategy
Sets out all Council expenditure that is capital in nature, i.e. expenditure on assets that provide benefits over more than one financial year.	Sets out how the Council manages its cash balances, and how capital financing (borrowing) requirements will be managed.	Sets out how the Council will manage non-treasury investments.

1.3 Recent treasury management activity has seen the Council holding significant cash balances in relatively safe settings and not needing to take out new borrowing. Non-treasury investment activity has been on a small scale. The key features of activity for 2021/22 and onwards are:

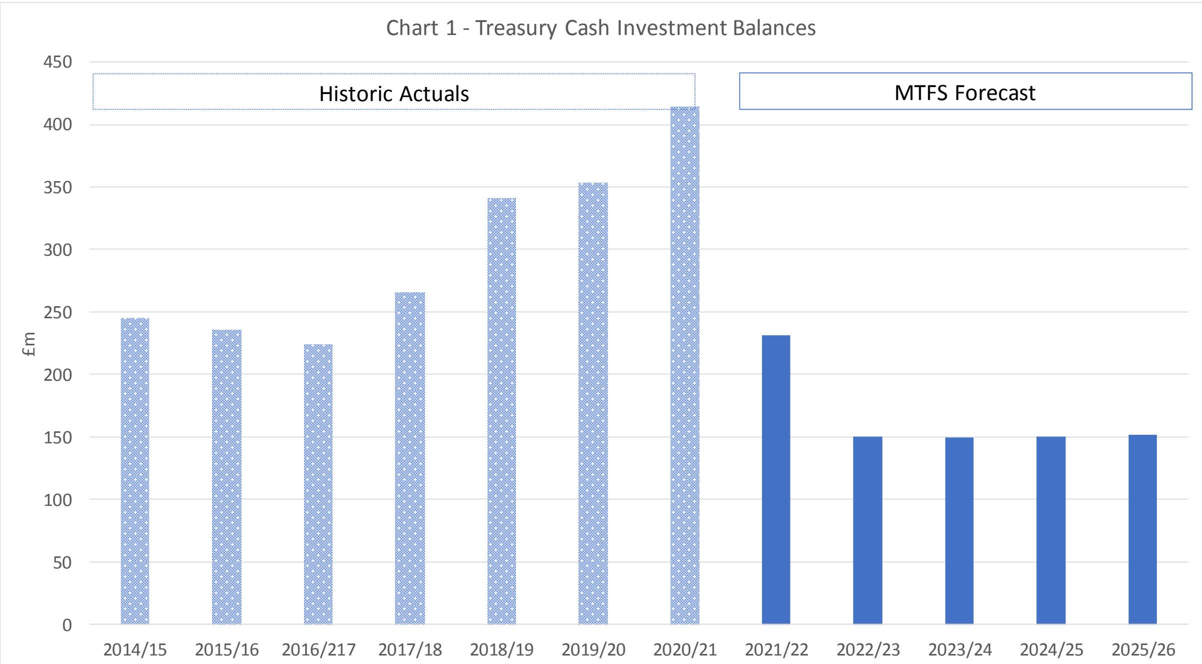
- Significant levels of new investment in the Warwickshire Property Development Company (WPDC).

- Significant increases in the level of borrowing to fund the WPDC and mainstream capital programme.

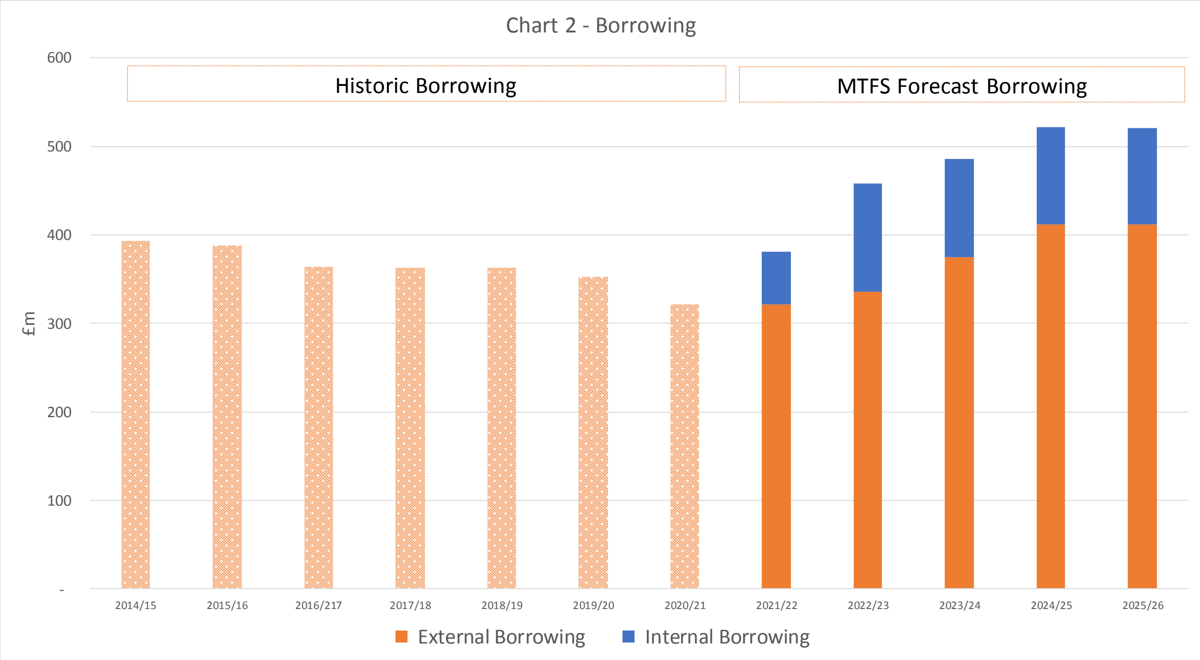
- Challenges in the efficient management of cash balances in an environment of sustained low interest rates and a higher risk of cashflow pressure.

2. Treasury Management (Appendix 2) - Headlines

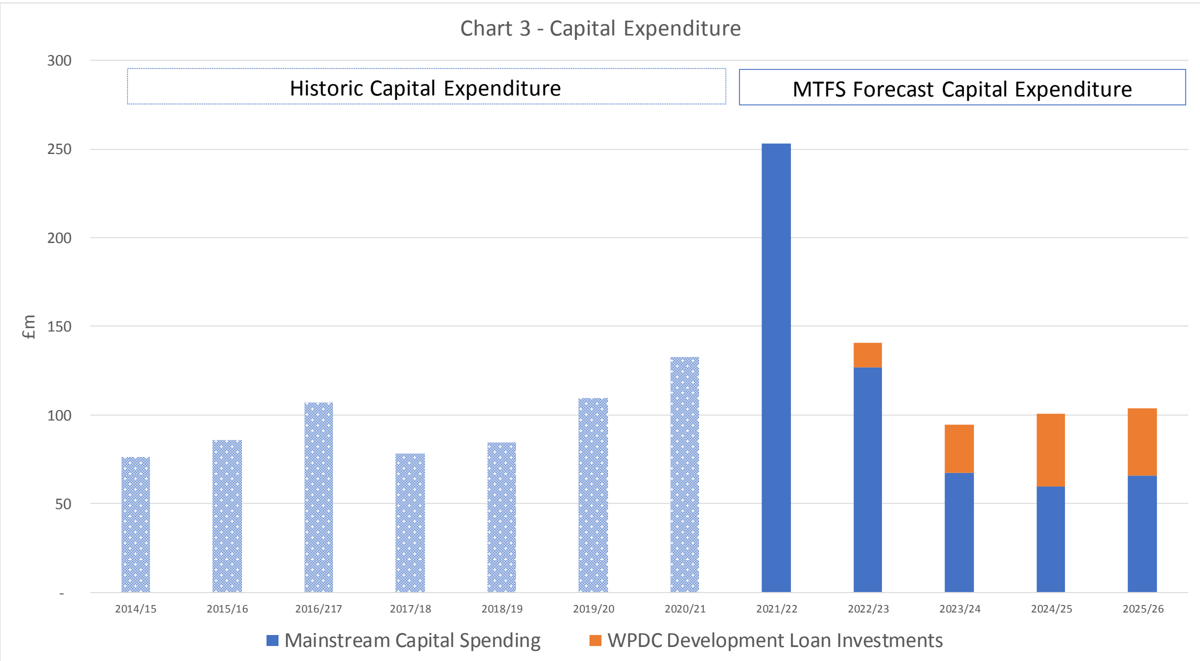
2.1 Treasury management is to do with the safe handling of cash (the priorities are ensuring security and liquidity, followed by the objective of earning an efficient return). Treasury cash balances are planned to reduce as follows:



2.2 This is driven by planned “internal borrowing” (also called “under borrowing”) whereby the Council makes use of cash balances where they are available in order to reduce the amount of external borrowing required to support new investment, because internal borrowing is cheaper (Appendix 2, Table 7). Chart 2 summarises the borrowing forecast and shows how a part of that increase will be through internal borrowing.



2.3 Borrowing, also referred to as the Capital Financing Requirement or CFR (Appendix 2 Table 4) is forecast to increase driven by the planned capital strategy including new cash investments in WPDC, as illustrated below.



2.4 Note that the reduction in forecast mainstream capital spending (Appendix 2, Table 1) does not represent a planned reduction in activity, it merely represents the capital planning horizon. Actual planned spending for each year ahead is expected to rise to a higher level by the time planning for that year arrives. i.e. the new WPDC investment is not replacing mainstream capital expenditure, it will be adding to it.

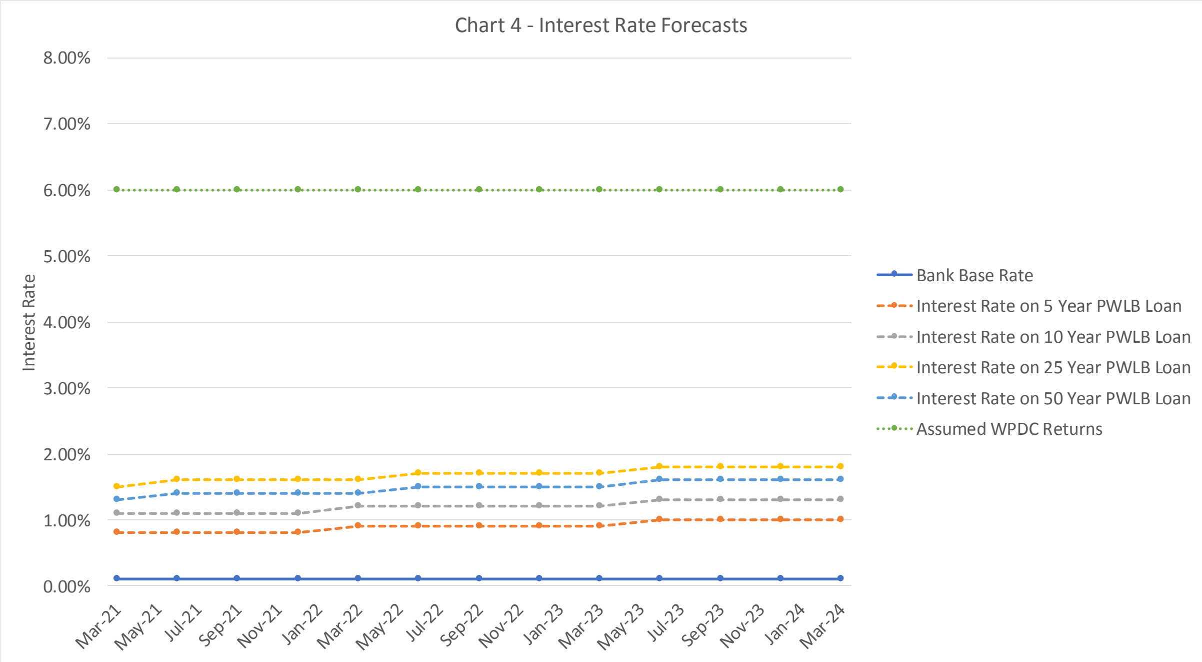
Minimum Revenue Provision

2.5 A prudent provision will be set aside to repay debt (this is called the Minimum Revenue Provision or “MRP”). For mainstream capital expenditure making this provision is existing custom and established practice.

2.6 The new MRP policy is expanded to have regard to the WPDC. For two elements of WPDC investment, no MRP will be made: (1) where land is transferred in as equity – because no borrowing is required, and (2) where working capital loans are made, because they are revenue rather than capital. For development loans to WPDC the loans are expected to be paid back however to be prudent MRP will still be provided for. The MRP policy is set out at Appendix 2 Section 2.4.

Interest Rates

2.7 Interest rates are very low and the outlook remains low with the bank rate forecast to stay at 0.1% for the next few years. The rates at which local authorities can borrow from the Public Works Loan Board (PWLB) are also very low , in the range 0.8% to 1.5% for durations from 5 years to 50 years and are only expected to rise slowly over the medium term (Appendix 2, Section 3.3).



2.8 Interest returns received on treasury investments will be significantly less over the medium term due to the low base rate. Some types of investment may involve negative interest rates. However actions will be taken to minimise the impact of low rates whilst prioritising security and liquidity.

2.9 The increase in non-treasury investments will provide a financial benefit through providing greater returns than treasury investments and greater returns than PWLB borrowing as illustrated in Chart 4 above, but at greater risk (refer to Section 3.6 below regarding risk).

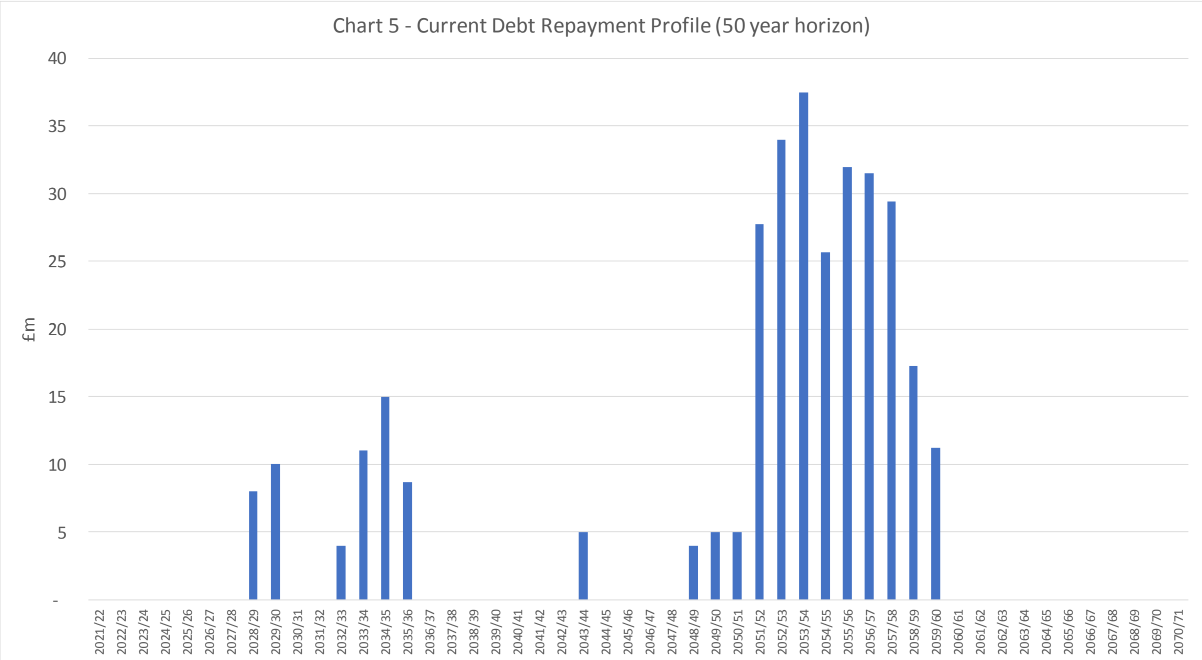
Borrowing

2.10 PWLB borrowing rates are very low (Appendix 2 Section 3.3) and a key issue will be to ensure that the Council maintains access to these rates (although alternatives will also be considered when borrowing is required to ensure best value is achieved). There are two specific factors that will be managed to achieve this:

- By providing HM Treasury with a forward forecast of capital plans local authorities can maintain access to the lowest rates (referred to as the "certainty rates").

- By making non-treasury investments that meet PWLB lending criteria (Appendix 3, Annex 1).

2.11 The current borrowing maturity profile includes a concentration of debt due to be repaid around 2050-2060. When new borrowing is taken out the opportunity will be taken to consider spreading out the maturity profile more evenly.



2.12 Limits for borrowing have been set based upon expected levels of investment, including an "Authorised Borrowing Limit" which cannot be exceeded (Appendix 2 Table 10).

Treasury Investments

2.13 Loans being made to other local authorities will be made on a smaller scale as internal borrowing reduces cash balances. The facility to agree loans to other local authorities in advance of the commencement date is being introduced. This will provide more opportunities and better value deals.

2.14 New limits have been introduced by investment sector to manage risk exposure, for example holding no more than £250m in overnight investments (Appendix 2 Section 4.3).

2.15 Counterparty credit rating requirements have been reduced from A to A- (long term Fitch rating) on investments with banks and building societies in order to maintain access to those institutions (Appendix 2 Section 4.2).

2.16 The minimum sovereign rating has moved down from AA to AA-, this incorporates the UK, however the rating requirement only applies to foreign countries, the strategy allows investment in the UK regardless of the UK’s rating (Appendix 2 Section 4.3).

3 Investment Strategy (Non-Treasury Investments - Appendix 3) – Headlines

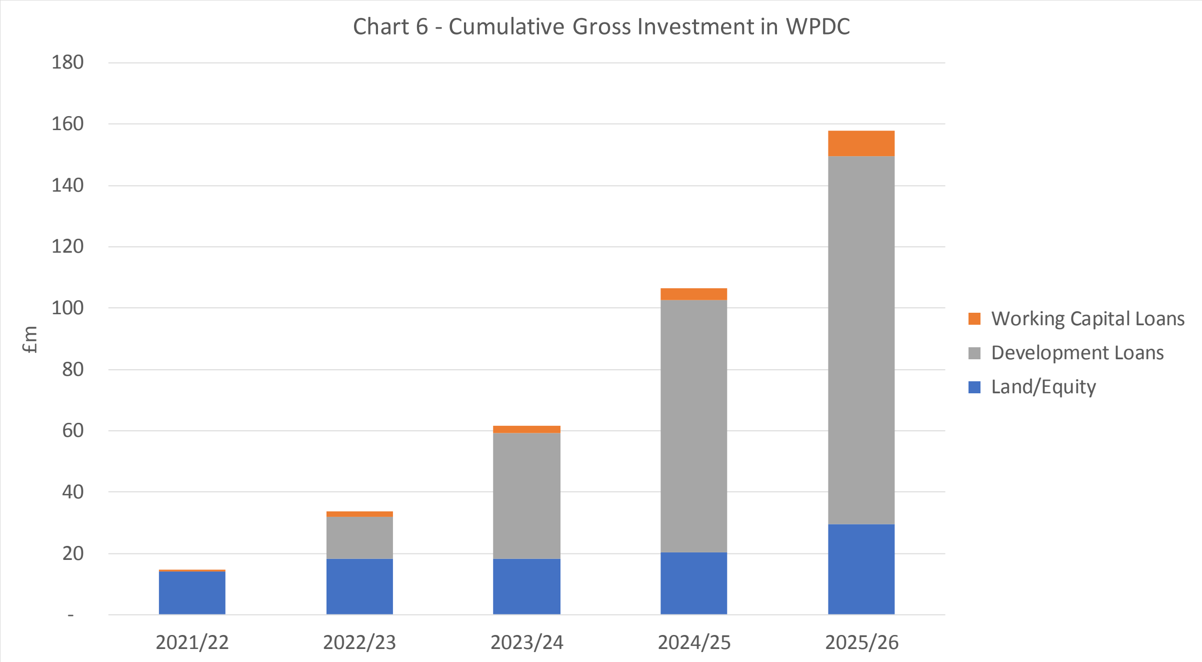
New Investments

3.1 The key non-treasury development is the introduction of new investment in the proposed WPDC, creating non-treasury investment on a significant scale that will be funded from borrowing.

3.2 In addition to the WPDC which was the subject of specific proposals to Cabinet in January 2021, further non treasury investments may be developed, for example there is the potential for a Warwickshire Recovery Investment Fund focused on investments to support local businesses and economic recovery. Where additional funds/investments are developed the Investment Strategy will be updated and presented to Members for approval as appropriate before new investments can be made.

3.3 An important feature of all non-treasury investments is that they are made with the primary purpose of delivering organisational objectives, and not purely or primarily to make a financial return (Appendix 3 Section 3). The primary reason for the proposal of the WPDC is to amplify the delivery of policy objectives.

3.4 The WPDC medium term investment plans are summarised in Chart 6. These represent limits and actual investment may be flexible up to these limits.



Existing Non-Treasury Investments

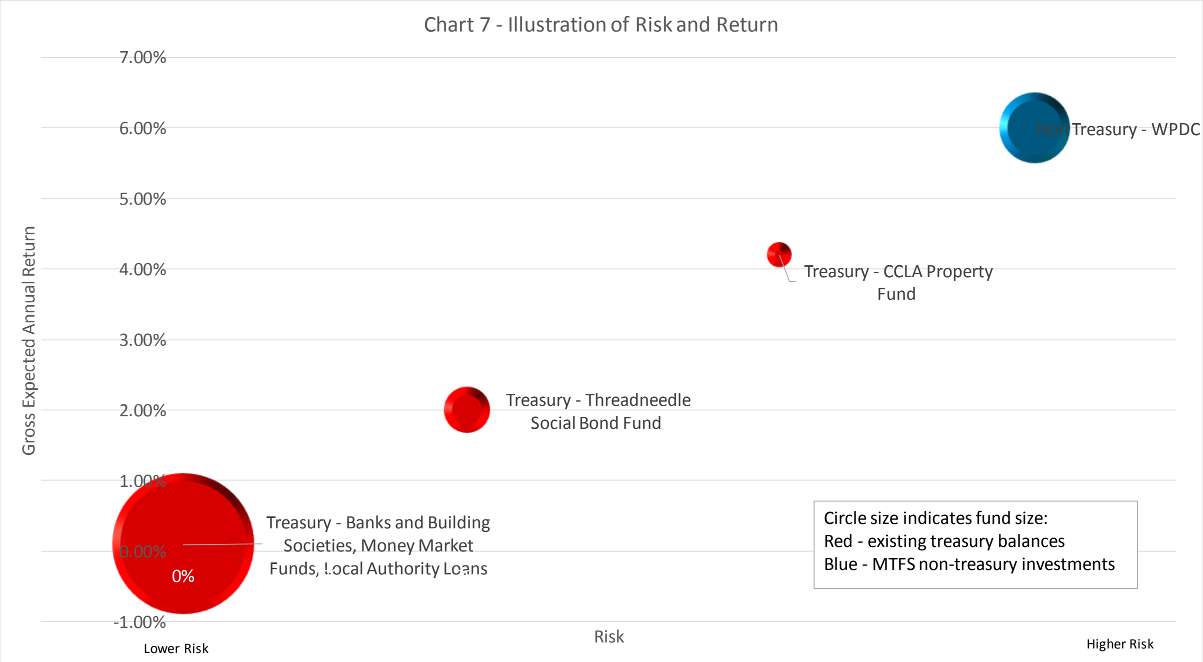
3.5 The Council already holds a small amount of non-treasury investments, all related to the delivery of service objectives (Appendix 3 Section 13). These are already fully funded or already paid for, example:

- Holding shares in companies such as the ESPO Trading Ltd and Warwick Technology Park.
- Issuing loans to Educaterers Ltd (a local authority controlled company).
- On a small scale issuing loans to local businesses through the capital programme and the Coventry and Warwickshire Reinvestment Trust.
- Holding a land bank of investment properties.

Risk

3.6 Any investment involves risk, with the risks depending upon the nature of the investment. A range of strategic governance and risk management standards are set out throughout the Investment Strategy which all non-treasury investments must adhere to (but refer to Appendix 3 Annex 2 – Annex 4 in particular). In addition, more detailed requirements may be determined for specific funds and incorporated into the approval of those funds.

3.7 Investment risk and return are directly linked, with higher risks typically being rewarded by higher returns. How financial risk actually manifests itself varies with the type of investment, for example equity risk manifests in the form of share price volatility, and lending risk manifests in the form of loan repayment default.



3.8 The financial risks and rewards involved in non-treasury investments are of a different nature to (and greater than) the financial risks relating to traditional capital expenditure and treasury investments (Appendix 3 Section 8). The chart above illustrates this schematically, with existing Treasury investments in red, and planned MTFS non-treasury investments in blue.

3.9 The reasons for the differences are:

- Treasury investments prioritise security and liquidity in order to serve the primary objective of treasury management which is to ensure that cash is available when needed to serve the purpose for which that cash is held.

- Traditional capital spending is basic expenditure by nature and is fully funded as such.

- Non-Treasury investment risks are different in that they are assumed to retain or increase their original asset value, and they are assumed to provide a more significant financial return. Therefore there is exposure to the risk of these assumptions not happening.

- The objectives of non-treasury investments by their nature are not the same as treasury investments, and therefore they may not prioritise security and liquidity as highly as treasury investments do.

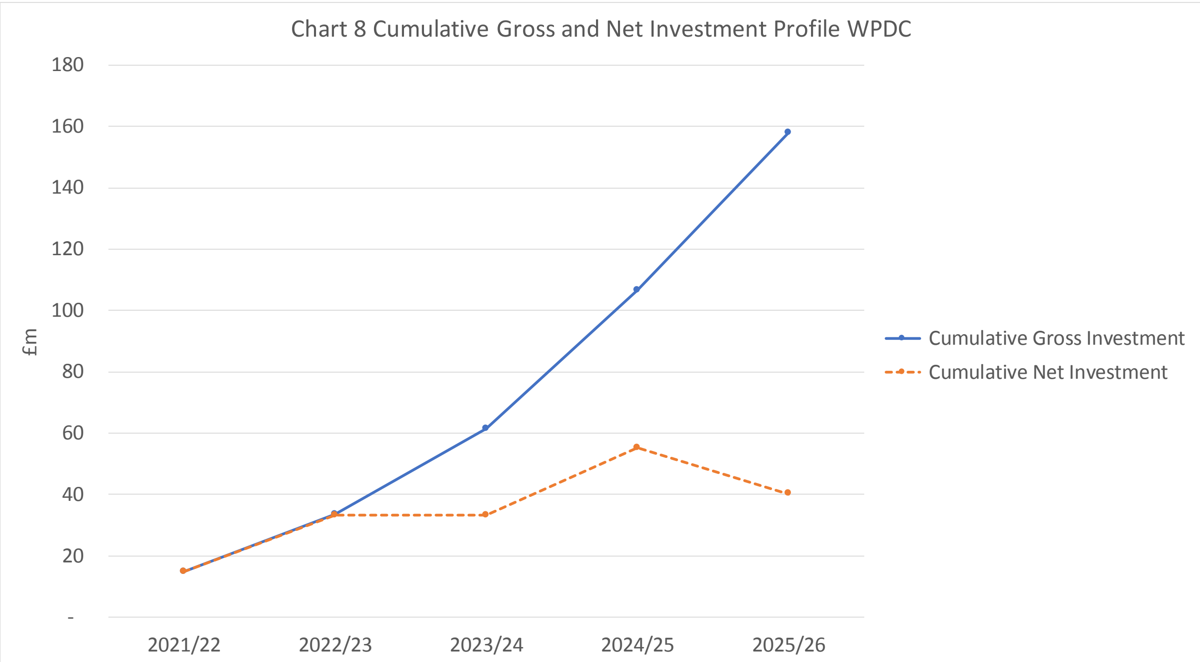
3.10 A key feature of managing risk will include having arrangements to manage the risk of losses. This will include a certain degree of expected losses built in to business models (no investment is 100% guaranteed to pay back), the use of reserves to provide some cover, and hard limits on non-treasury investment levels to limit maximum exposure to losses.

3.11 Some risks are driven by the duration of an investment. The longer the investment is for, the greater the probability is of a default. In addition, very long-term investments introduce intergenerational risks that need to be considered.

3.12 Aside from the risks associated with any particular individual investments, another type of risk is addressed by the Investment Strategy called “proportionality” (Appendix 3 Section 9). This is to do with the overall aggregate level of investment and exposure to loss, in particular in comparison to the size and financial capacity of a local authority to bear the losses that it is exposed to. The issue of proportionality will be monitored and proportionality measures may be used in the future to put limits on investment activity.

Prudential Indicators

3.13 The Investment Strategy has been updated to have regard to the new WPDC investments, including the introduction of Prudential Indicators (Appendix 3 Annex 7) that place limits on gross and net investment:



3.14 The gross amount that may be invested in each fund annually is a hard ceiling within each year. The net level of investment will be monitored (i.e. after accounting for repayment of previous investments). If the annual net position is breached due to repayment defaults, this would trigger a review of future gross investment limits.

3.15 In addition, the following more detailed limits will be applied to manage risk (Appendix 3 Annex 7).

- The length of time that investments may be made for.

- The amount of a fund that may be debt or equity investment.

3.16 The “Authorised Borrowing Limit” set within the Treasury Management Strategy (Appendix 2, Table 10) includes borrowing required to service these investments.

3.17 All non-treasury management investments will be required to demonstrate that they meet the following criteria:

- That they are primarily for the purpose of delivering organisational objectives and meeting service need.

- That they meet the revised criteria recently set out by the Government that need to be met in order to retain access to PWLB lending. The government as specified the kinds of investment that may be made (Appendix 3 Section 3.2). It is possible to invest in other initiatives but if that were the case, the local authority would have to find borrowing sources from elsewhere and would likely be considered a higher risk to lend to.

- That whilst they may make a financial return, they must not be purely or primarily for the purpose of making a financial return.

Governance

3.18 High level requirements for the governance of non-treasury investments are specified in the Investment Strategy (Appendix 3). These are the minimum requirements that must be met. Where specific investments or funds are developed, they may prescribe more detail around their governance arrangements, but those arrangements must meet these strategic requirements.

4 Financial Implications

4.1 The financial implications are detailed within the report and appendices.

5 Environmental Implications

5.1 Both strategies include an “Environmental Social and Governance” (ESG) policy. The primary objectives of treasury management will however remain security, liquidity, and yield, with non-treasury investments also including the delivery of organisational service objectives.

6 Supporting Information

6.1 None.

7 Timescales Associated with Next Steps

7.1 The Treasury Management Strategy and Investment Strategy will, subject to approval, come into effect on 1st April 2021.

Appendices

- Appendix 1 - Explanation of Capital Expenditure, Treasury Investments, and Non-Treasury Investments
- Appendix 2 - Treasury Management Strategy
- Appendix 3 - Investment Strategy (for Non Treasury Investments)

Background Papers

None

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The report was circulated to the following members prior to publication:

Cabinet 28 Jan 2020

Explanation of Capital Expenditure, Treasury Investments, and Non-Treasury Investments **Appendix 1**

	Capital Expenditure	**Treasury Investments**	**Non-Treasury Investments**
Purpose	Traditional capital expenditure to meet service objectives	Maximising the security and liquidity of cash, and generating the most efficient returns without compromising the required security and liquidity	Investment in assets in order to meet service objectives and/or commercial objectives
Investment Timescales	Generally long term	Generally short-term (up to 1 year)	Short term through to very long term - dependent on objectives
Outcome for Asset Value	Assets are consumed through their working life and are assumed to have no remaining value at the end of their working life. New funding is then required to purchase or create a new asset.	The preservation of capital (security) is the top priority. Assets are only held until the cash is needed for its original underlying purpose (for example a capital receipt that was held until it was spent).	Asset values are assumed to be maintained and repaid where investments are loans by nature. Where investments are equity in nature then either (1) asset values are assumed to be maintained and/or increase or (2) be replaced by other value (e.g. dividends, capital receipts).
Sources of Funding	Investment is permanent (i.e. the investment does not come back). Sources include capital receipts and grants, and borrowing. Provision is made for replacement costs via the MTFS.	Investments are temporary (i.e. investments are assumed to come back eventually) Cash balances provide the funding.	Investments are temporary (i.e. investments are assumed to come back eventually). Primarily borrowing and cash balances
Risk	Assets are fully funded, so there is no risk of a loss of an assumed financial investment as such, however there are risks for example (1) cost over-run and (2) that an asset does not deliver its objectives, and that this has knock-on implications.	Credit and liquidity risk exist but are minimised, for example by restricting investments to counterparties with high credit ratings, and restricting investments to shorter durations.	Risks are directly dependent upon the nature of the investments undertaken, and the governance and controls built around them. Risks relate to individual investments, and also emerge from the aggregate total amount of activity.
Primarily covered by which strategy document?	**Capital Strategy** • Capital plans also feature in the Treasury Strategy as they drive borrowing and cash planning.	**Treasury Management Strategy**	**Investment Strategy** • Will also feature in the capital strategy where investment is capital in nature and has to be accounted for as such. • Will also feature in the Treasury Strategy where the investment drives borrowing or the use of cash balances.
Examples of what this covers in practice	Traditional capital expenditure, for example on roads, IT infrastructure, etc.	• Loans to Banks, Building Societies and other Local Authorities • Investments in Money Market Funds • Investment in the CCLA Property Fund • etc	• Pre-existing non-treasury investments (e.g. land bank, companies such as ESPO, loans to Educaterers, and loans made via CWRT). • WPDC