Council

7 February 2023

Treasury Management Strategy and Investment Strategy

Recommendations

That Council:

1. Approves the Treasury Management Strategy for 2023/24 (Appendix 2) with effect from 1st April 2023.

2. Approves the Investment Strategy for 2023/24 (Appendix 3) with effect from 1st April 2023.

3. Requires the Strategic Director for Resources to ensure that gross borrowing does not exceed the prudential level specified (Appendix 2, Section 3.22, Table 12 “Authorised Borrowing Limit”).

4. Approves the revised lending limits for the Warwickshire Property Development Group (Appendix 3 Annex 7).

5. Approves the revised lending limits for the WRIF (Appendix 3 Annex 7).

6. 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).

7. Delegates 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).

8. Requires the Strategic Director for Resources to implement the Minimum Revenue Provision (MRP) Policy (Appendix 2, Section 2.11).

9. Requires the Strategic Director for Resources to enact an early payment of pension fund contributions subject to the conditions set out in Appendix 1, Section 5.14 being met.

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 Treasury Management activity in the years prior to 2022 has focused on managing the significant cash balances of the Council in secure and liquid settings as needed.

1.4 Thanks to these high cash balances, no borrowing has been required to finance the capital programme of the Council.

1.5 2021/22 and 2022/23 has seen the launch and full year activity of 2 new strategic investments made by the Council:

- Warwickshire Recovery Investment Fund (WRIF); and
- Warwickshire Property and Development Group (WPDG).

1.6 The financial year 2022/23 has seen 2 very different periods of economic activity; the first half of the year saw the tail end of the Covid-19 pandemic as the country returned to normal, while the second has seen political instability and huge fluctuations in economic markets.

1.7 These economic circumstances in the second half of the year so far have caused a dramatic rise in inflation, reaching a 41 year high, and also a rise in interest rates from the lows of the Covid-19 Pandemic. The impact of these on treasury management returns will prove significant in the second half of the year.

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 driven by “internal borrowing” whereby the Council makes use of temporarily available cash balances in order to reduce the amount of external borrowing required to support new investment. This approach is taken because internal borrowing is cheaper than external borrowing. Appendix 2 Table 7 shows how the position will move in this direction and become "under borrowed" (i.e. the Council will be borrowing both externally and internally rather than just externally).

2.2 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 investments in WPDG and the WRIF.

Changes to the Prudential Code and Treasury Management Code.

In December 2021 CIPFA published a revised Prudential Code and Treasury Management Code to be adopted by 2023/24. The relevant changes to these codes regarding this strategy are:

- Revised Prudential Indicators to show affordability and prudence;
- Liability Benchmark introduced as an indicator;
- Inclusion of ESG considerations in credit and counterparty polices;
- Knowledge and Skills schedule to the included in reporting and strategy;
- Revised definitions of the term "investments";
- Non-Treasury Activity to have a separate policy document; and
- Local Authorities must not borrow to invest for the sole purpose of financial return.

Other changes to Treasury Management Practices include:

- Extended time periods for investment counterparties; and
- Extended amount limits for investment sectors.

Interest Rates

2.3 Interest rates are very volatile. The outlook for 2023/24 is for rates to rise and peak during the year before settling. The bank rate rose to 3.5% in December 2022 in a further effort to slow the rapid rise in inflation. The rates at which local authorities can borrow from the Public Works Loan Board (PWLB) have risen from historic lows at the end of 2021/22 to far higher cost of borrowing, in line with the trend in interest rates.

2.4 Interest returns received on treasury investments will fluctuate during the year as the economy begins to stabilise after a period of volatility. However, compared to previous years the treasury management returns are expected to be higher than the last 2 years due to the significant increase in interest rates following the Pandemic.

2.5 The increase in non-treasury investments will provide a financial benefit by providing greater returns than treasury investments and greater returns than PWLB borrowing, but at greater risk.

Borrowing

2.6 PWLB borrowing is expected to be more expensive than in previous years (Appendix 2 Section 3). A key requirement 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”); and
- By making non-treasury investments that meet PWLB lending criteria (Appendix 3, Annex 1).

2.7 The current borrowing maturity profile includes a concentration of debt due to be repaid around 2050-2060 (Appendix 2 Annex 2). When new borrowing is taken out the opportunity will be taken to consider spreading out the maturity profile more evenly.

2.8 Limits for borrowing have been set based upon expected levels of investment, including an “Authorised Borrowing Limit” which cannot be exceeded (Appendix 2, Table 12).

Pension Contributions

2.9 The Council will consider a payment of its 3-year pension fund contributions (for the valuation period 2023/24-2025/26) in one lump sum at the start of the valuation period. An early payment in April 2023 would be given a discount rate compared to cash payments made at normal monthly intervals.

2.10 The benefits for making this early payment include a gross saving of £6m total cash contributions over the 3 year period. A net one off saving is possible after having regard to the reduced Treasury Management returns should the payment be made.

2.11 Various costs and risks need to be considered if making an early pension contribution payment, these are set out in Section 5 of Appendix 1.

2.12 The payment will only be made based on the several conditions being met. These are listed in Section 5.14 of Appendix 1.

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

3.1 The significant non-treasury developments, WPDG and WRIF, will continue in full operation in 2023/24. Both initiatives have refreshed strategies, including a reduction of the total WRIF budget as per the WRIF Business Plan. These initiatives continue to create non-treasury investments on a significant scale that will be funded from internal and external borrowing.

3.2 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 objectives of the WPDG and WRIF reflect this requirement, and are set out in their respective strategies.

3.3 The Council holds a small amount of other non-treasury investments, all related to the delivery of service objectives (Appendix 3, Section 14). These are already fully funded or otherwise paid for, 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; and
- Holding a land bank of investment properties.

Risk

3.4 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 (as set out in Appendix 3, Annex 2 – Annex 4). In addition, more detailed requirements may be determined for specific funds and incorporated into the approval of those funds.

3.5 Investment risk and return are linked, with higher risks typically being rewarded by higher returns. How financial risk 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.

3.6 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).

3.7 The reasons for the differences are:

- Treasury investments prioritise security and liquidity 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 although they are made with the primary purpose of delivering organisational objectives, and not purely or primarily to make a financial return, they are assumed to retain or increase their original asset value and are assumed to provide a more significant financial return than traditional treasury investments. 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.

3.8 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 into 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.

3.9 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.

3.10 Aside from the risks associated with any 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 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

3.11 The Investment Strategy has been updated to have regard to revised investment plans, including the relevant Prudential Indicators (Appendix 3 Annex 7) that place limits on gross and net investment.

3.12 The gross amount that may be invested in each fund annually is controlled by 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 lower than expected due to repayment defaults, this would trigger a review of future gross investment limits.

3.13 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; and
- the amount of a fund that may be debt or equity investment.

3.14 The “Authorised Borrowing Limit” set within the Treasury Management Strategy (Appendix 2, Table 12) includes borrowing required to service these investments.

3.15 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 to retain access to PWLB lending. The Government has specified the kinds of investment that may be made (Appendix 3 Section 3). 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 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

3.16 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 Timescales Associated with Next Steps

6.1 The Treasury Management Strategy and Investment Strategy will, subject to approval by Council, come into effect on 1st April 2023.

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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