Cabinet

23 January 2024

Treasury Management Strategy and Investment Strategy

Recommendations

That Cabinet recommends to Council to:

1. Approve the Treasury Management Strategy for 2024/25 (Appendix 2) with effect from 1 April 2024;

2. Approve the Investment Strategy for 2024/25 (Appendix 3) with effect from 1 April 2024;

3. Require the Executive Director for Resources to ensure that gross borrowing does not exceed the prudential level specified (Appendix 2, Section 3.13, Table 12 “Authorised Borrowing Limit”);

4. Approve the revised lending limits for the Warwickshire Property Development Group (WPDG) (Appendix 3, Annex 7);

5. Approve the revised lending limits for the Warwickshire Recovery Investment Fund (WRIF) (Appendix 3, Annex 7);

6. Require the Executive Director for Resources to ensure that gross investment in non-Treasury investments does not exceed the prudential levels specified (Appendix 3, Annex 7);

7. Delegate authority to the Executive Director for Resources to undertake such delegated responsibilities as are set out in Appendix 2, Annex 7, and Appendix 3, Section 2.5;

8. Require the Strategic Director for Resources to implement the Minimum Revenue Provision (MRP) Policy (Appendix 2, Section 2.11-2.26); and

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 has been focused on managing the cash balances of the Council in secure and liquid settings as needed, following the priority of security being the most important consideration, followed by liquidity, with yield being important but not as important as security and liquidity. This is covered in the Treasury Management Strategy (Appendix 2).

1.4 The strategic investments made by the Council are covered in the Investment Strategy (Appendix 3). These investments include, but are not limited to the

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

1.5 Due to the level of cash balances held by the Council, no new external borrowing has been required to finance the capital programme of the Council or its Investment activity in recent years.

1.6 The financial year 2023/24 has seen a sustained period of volatile economic activity, with inflation remaining high although it has begun to reduce and interest rates have stabilised after a period of significant increase.

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. Internal borrowing is preferred where possible because internal borrowing is cheaper than external borrowing. Appendix 2, Table 7 shows how the position will move in this direction and become increasingly “under borrowed” (i.e. the Council will be borrowing both externally and internally rather than just externally).

2.2 The need to borrow, 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.

Interest Rates

2.3 Interest rates reached a peak during the year and have remained high. The outlook for 2024/25 is expected to be that rates settle and gradually reduce during the year. The rates at which local authorities can borrow have risen from the historic lows at the end of 2021/22, in line with the trend in interest rates.

2.4 Interest returns received on treasury investments have reflected the interest rates in the marketplace. This is expected to reduce during the year 2024/25 as both the interest rates are expected to fall, and the overall treasury portfolio size will reduce.

2.5 Non-treasury investments provide financial returns that reflect market rates, having regard to covering the Council's costs and reflecting risk.

Borrowing

2.6 Taking out new PWLB borrowing is now more expensive than it has been in recent years (Appendix 2 Section 3) but it is still a relatively low cost source of financing. A key requirement will be to ensure that the Council maintains access to PWLB rates when it does need to borrow (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).

2.9 The Minimum Revenue Provision (MRP) that is used to reflect the repayment of borrowing principal has been amended. For the majority of capital spending financed by borrowing the MRP remains unchanged. However, as a result of changes to government statutory guidance and regulations, from the 1 April 2024 MRP will in future only be charged for capital WPDG and WRIF loans where there is an expectation of a default (Appendix 2, Section 2.18-2.22). Separately, MRP in respect of leases accounted for under a new accounting standard IFRS16 with effect from 1 April 2024 will be managed in such a way as to avoid double counting of leasing charges in the revenue budget (Appendix 2, Section 2.22-2.24).

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

3.1 The WPDG and WRIF will continue in 2024/25. Both initiatives have refreshed strategies, including a reduction of the total WRIF budget and the closure of the Business Investment Growth (BIG) pillar of the WRIF as per the WRIF Business Plan, which is approved annually by Cabinet and the updated WRIF Investment Strategy and Business Plan are elsewhere on this committee meeting's agenda. These initiatives continue to create non-treasury investments that will be funded from internal and external borrowing.

3.2 The final WPDG and Joint Venture Business Plan is not yet completed and will be received and considered by officers between the date of this Report and the final consideration of the Treasury Management Strategy by Council in February. The Executive Director for Resources will consider whether any changes are required to the Treasury Management Strategy as a result and these will be noted and explained to full Council as part of the approval process.

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

3.4 The Council holds a small amount of other non-treasury investments, all related to the delivery of service objectives (Appendix 3, Section 14).

Risk

3.5 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.

3.6 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.

3.7 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).

3.8 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.

3.9 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.

3.10 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.

3.11 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

3.12 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.

3.13 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.

3.14 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.

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

3.16 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

3.17 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 2024.

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:
Local Member(s):
Other members:

Appendix 1

Explanation of Capital Expenditure, Treasury Investments, and Non-Treasury Investments

	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 to meet service objectives and/or commercial objectives
Investment Timescales	Long term	Short-term (up to 1 year)	Short term through to exceptionally 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 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 must 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	• Pre-existing non-treasury investments (e.g. land bank, companies such as ESPO, loans to Educaterers, and loans made via CWRT). • WPDG