
Welsh Government
STATUTORY GUIDANCE ON
LOCAL GOVERNMENT INVESTMENTS

Issued under section 15(1) (a) of the *Local Government Act 2003* effective for financial years commencing on or after 1 April 2020

POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following guidance is issued by Welsh Ministers under section 15(1) (a) and 24 of the *Local Government Act 2003*. Under that section local authorities are required to "have regard" to "such guidance as Welsh Ministers may issue".

DEFINITIONS OF TERMS

2. In this guidance, **2003 Act** means the *Local Government Act 2003*.
3. **Local authority** has the meaning given in section 23 of the 2003 Act (and in regulations made under that section). To the extent that this guidance applies to community and town councils and charter trustees (see paragraph 12), a reference to a "local authority" includes those councils and trustees.
4. An **investment** is something held or a transaction which relies upon the power in section 12 of the 2003 Act¹. That is for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs. This covers all of the financial and non-financial assets a local authority has invested money into primarily or partially for the purpose of generating a surplus including investment property. As such this may include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

¹ <https://www.legislation.gov.uk/ukpga/2003/26/section/12>

5. The definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party.
 6. The term does not include *pension fund and trust fund investments*, which are subject to separate regulatory regimes and are therefore not covered by this guidance.
 7. A ***long-term investment*** is any investment other than one which is due to be repaid within 12 months of the date on which the investment was made.
 8. A ***credit rating agency*** is one of the following three companies: *Standard and Poor's; Moody's Investors Service Ltd; Fitch Ratings Ltd.*
 9. For the purposes of this guidance a ***loan*** is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan. This definition does not include a loan to another local authority, which is classified as a specified investment.
10. A ***specified investment*** is an investment which all of the following applies
- (a) the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
 - (b) the investment is not a *long-term investment* (as defined in paragraph 7) with the exception of a loan to another local authority;
 - (c) the making of the investment is not defined as *capital expenditure* by virtue of regulation 20(1)(d) of the *Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]*;
 - (d) the investment is made with a body or in an investment scheme of *high credit quality*; or with one of the following public-sector bodies:
 - (i) the United Kingdom Government
 - (ii) a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
 - (iii) a town or community council.

APPLICATION

Effective date

11. This guidance applies for financial years commencing on or after 1 April 2020 and supersedes the guidance issued April 2010.

Local authorities

12. This guidance applies to all local authorities in Wales.

Town and Community councils and charter trustees

13. This guidance applies to Town and Community Councils and Charter Trustees with total investments expected to exceed £250,000 at any time during the financial year.

14. All other town and community councils and charter trustees whose investments are not expected to exceed £250,000 shall have due regard to this guidance and give priority to security and liquidity rather than to yield for any investments they undertake. The level of detail and specific requirements outlined in this guidance will therefore not apply but all Town and Community Councils or Charter Trusts should;

- (i) agree a Capital Strategy before the start of the financial year as a minimum; this can be undertaken as a part of the budget setting process;
- (ii) agree appropriate limits for each category of investments it plans to carry out;
- (iii) agree a process that effectively monitors the strategy in year, and;
- (iv) ensure that all investments are in Sterling;

INVESTMENT STRATEGY

Preparation

15. For each financial year a local authority must prepare at least one investment Strategy (“the Strategy”) in accordance with the disclosures and reporting requirements specified in this guidance.
16. The function of a Capital Strategy in CIPFA’s updated Prudential Code is to ‘set out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes. Therefore where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code or any other publicly available document, the disclosures required for the strategy can be incorporated into those documents.

Approval

17. The Strategy should be approved by the full council. For authorities without a full council such as Fire & Rescue Service authorities, the Strategy should be approved at the closest equivalent level.

Timing

18. Welsh Ministers recommend that for any financial year an investment Strategy (“the initial Strategy”) should be prepared and approved before the start of that year.
19. The initial Strategy may be replaced by another Strategy (“the revised Strategy”) at any time during the year, on one or more occasions, subject to the same process of approval. The initial Strategy should specify circumstances in which a revised Strategy is to be prepared, but a revised Strategy may be prepared in other circumstances, if at any time it is considered appropriate.

Publication

20. The initial Strategy and any revised Strategy should, when approved, be made available to the public free of charge, in print or online.

KEY POLICY PRINCIPLES

21. The Strategy should set out the authority's policies for the prudent management of its investments and for giving priority, firstly, to the security of those investments and, secondly, to their liquidity. It should therefore identify the procedures for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

POWER TO INVEST

22. Local authority investment powers are for any purpose relevant to its functions and for the purposes of the prudent management of its financial affairs. As with all local authority powers they must be used reasonably and in accordance with an authority's primary function to serve the public, for example, to provide public services and to promote its wellbeing.

CLASSIFICATION

23. Financial and Non-financial Investments made by local authorities can be classified into one of three main categories;

- (i) Investments held for treasury management purposes;
- (ii) Commercial investments; and
- (iii) Other Investments relevant to council functions.

24. Where local authorities hold treasury management investments, they should apply the principles set out in the CIPFA Treasury Management Code. They should disclose the contribution these investments make to the objectives of the local authority to support effective treasury management activities.

25. Local authorities should disclose the contribution that commercial investments i.e. an investment in a for-profit enterprise involved in the buying or selling of goods and services, with the expectation of generating cash flow make towards the service delivery objectives and/or to promote wellbeing.

26. Local authorities should disclose the contribution that other investments make towards the service delivery objectives and/or to promote wellbeing.

27. Local authorities should disclose to what extent investment decisions consider long-term climate risks to support a low carbon economy.

Financial Investments

28. Financial investments can fall into one of three categories;

- (i) ***Specified Investments***
- (ii) ***Loans***; and
- (iii) ***Other Non-specified investments***

Specified investments

29. Where the investment is made with a body or in an investment scheme of *high credit quality*, Welsh ministers recommend that the Strategy should define *high credit quality* (and where this definition refers to *credit ratings*, paragraph 47 is relevant)

Loans

30. A local authority may choose to make ***loans*** to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth. If adopting a narrow definition of prioritising security and liquidity these loans may not be viewed as prudent.

31. However local authorities can make such loans whilst having regard to this guidance if they can demonstrate in their strategy that;

- (i) Financial exposure to these type of loans is proportionate;
- (ii) They have used an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of their loan portfolio;
- (iii) Appropriate consideration has been given to state aid rules and competition law;
- (iv) They have appropriate credit control arrangements to recover overdue repayments in place; and
- (v) The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

Non-specified investments

32. With regard to ***non-specified investments*** (i.e those not meeting the definition of a specified investment or a loan), Welsh Ministers recommend the Strategy should:

- (a) set out procedures for determining which categories of such investments may prudently be used (and where these procedures involves the use of *credit ratings*, paragraph 47 is relevant);
- (b) identify which categories of such investments have identified as suitable for prudent use during the financial year;
- (c) state the upper limits for the maximum amounts both individually and cumulatively which, at any time during the financial year, may be held in each identified category (the limits being defined by reference to a sum of money or a percentage of the local authority's overall investments or both) and;
- (d) For the overall amount which may be held in non-specified investments confirm that investments have remained within those limits.

Non-Financial Investments

- 33. As defined in paragraph 4 of this guidance non-financial investments are non-financial assets held primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset or assets that can be realised to recoup the capital invested.
- 34. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in *International Accounting Standard 40: Investment Property* as adapted by proper practices.
- 35. Local authorities should consider whether the scale of commercial investments including property are proportionate to the resources of the authority and consistent with the requirements of the Prudential Code and the Treasury Management Code.
- 36. It is vital that local authorities understand the impact of investments in commercial activities in both the medium-term financial plan and longer-term. It is important that local authorities understand the impact of such investments over their term, to ensure there is long-term affordability and financial sustainability/resilience relating to them.

SECURITY, LIQUIDITY AND YIELD

37. A prudent investment policy will have two underlying objectives;

- (i) **Security** – protecting the capital sum invested from loss; and
- (ii) **Liquidity** – ensuring the funds invested are available for expenditure when needed.

38. The generation of **yield** is distinct from these prudential objectives.

However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these objectives.

Security

39. The Prudential Code sets out clearly that the prime policy objective of a local authority's treasury management investment activities is the security of funds, and that a local authority should avoid exposing public funds to unnecessary or unquantified risk.

40. Where fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

41. Where fair value of non-financial investments is no longer sufficient to provide security against a material loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

42. Where a local authority recognises a material loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council. This could be provided as part of the next budgeting setting process and should detail the impact of the loss on the security of investments and any revenue consequences arising from therefrom.

Liquidity

43. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may be prudently committed. It should

also state what those maximum periods are and how the local authority will stay within its stated investment limits.

44. For non-financial investments the Strategy should set out the procedures for ensuring the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions.
45. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at portfolio level if appropriate.

Yield (net profit)

46. Local authorities may consider it necessary to utilise their profit generating investment activity to achieve a balanced revenue budget. Where this is the case the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and or promote wellbeing in that local authority is dependent on achieving the expected yield. The Strategy should detail the local authority's contingency plans should it fail to achieve the expected yield.
47. The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is strongly advised.

INVESTMENT RISK

Risk assessment

48. Welsh Ministers recommend that the Strategy should set out the authority's approach to assessing the risk of loss before entering into and whilst holding investments, making clear in particular:

- (a) To what extent, if any, risk assessment is based upon credit ratings issued by one or more credit rating agencies.
- (b) Where credit ratings are used, how frequently credit ratings are monitored and what action is to be taken when ratings change; and
- (c) What other sources of information are used to assess or monitor risk.

Treasury management advisers

49. Welsh Ministers recommend that the Strategy should state:

- (a) Whether and, if so, how the authority uses external advisers offering information, advice or assistance relating to investment; and
- (b) How the authority monitors and maintains the quality of any such service.

INVESTMENT OF MONEY BORROWED

50. Authorities must not borrow more than or in advance of their need purely in order to profit from the investment of the extra sums borrowed.

51. Where a local authority, after having regard to the provisions in this guidance and the CIPFA Prudential Code, decides to depart from any of the explicit provisions of those publications, it will still need to ensure it meets the requirements of the powers and duties afforded by Chapter 1 of the Local Government Act 2003. Additionally the Strategy should;

- (iii) Identify the legal powers that support the proposed transactions;
- (iv) Demonstrate the exercise of these powers are reasonable;
- (v) Explain the local authority's policies in investing the money borrowed, including how it demonstrates value for money and can ensure the security of such funds; and
- (vi) Confirm the authority wishes to proceed by approval from full council.

CAPACITY SKILLS AND CULTURE

52. The Strategy should disclose the steps taken to ensure those elected members and statutory officers involved in the investments decision making process have the appropriate capacity, skills and information to;
- (i) enable them to take informed decisions as to whether to enter into a specific investment;
 - (ii) assess individual assessments in the context of the strategic objectives and risk profile of the local authority; and
 - (iii) enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.
53. The Strategy should disclose the steps taken to ensure those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.
54. Where appropriate the Strategy should comment on the corporate governance arrangements in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

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