Appendix A

Treasury Management Strategy

Medway Council

2018/19

Contents

Introduction

1.1. The Council is required to operate a balanced budget, which 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 risk appetite, providing adequate liquidity initially before considering investment return.

1.2. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3. 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*."

1.4. The Prudential Code prevents the authority borrowing for revenue purposes. Non- current assets not financed by unuseable reserves are financed by borrowing. This borrowing need is known as the capital financing requirement (CFR).

1.5. Borrowing may be from external sources such as the Public Works Loans Board, other authorities or commercial sources or it may be borrowed internally using cash otherwise available for investment (useable reserves). If internal borrowing takes place, the authority is said to be under borrowed. This does not imply that the authority should necessarily increase its external borrowing but merely reflects the extent to which additional external borrowing would be lawful.

1.6. The authority cannot borrow in excess of the CFR except where it is borrowing in advance of need to void expected interest rate rises. If it were to borrow in excess of CFR for an extended period, this would be borrowing for revenue purposes which is unlawful. The Council sets an authorised limit to take account of any such borrowing in advance of need. Our practice is to set the authorised limit 10% higher than CFR.

1.7. Authorities are required to set aside part of their revenue budgets each year and place this is an unuseable reserve as a provision to repay borrowing. This requirement is known as the minimum revenue provision MRP. Many authorities have built up large cash balances because their annual MRP exceeds their need to fund capital expenditure.

1.8. Authorities have been given freedom to determine the methodology for calculating MRP. Medway members approved the use of an annuity method of provision which resulted in around £3million less MRP than under the traditional straight line approach. Under the annuity basis smaller sums are provided in the early years of the loan but these increase year on year. The effect is a bit like the principal element of a repayment mortgage where in the early years little of the monthly is repaid but towards the end of the mortgage most of the repayment is of the capital outstanding. However unlike the repayment mortgage the interest element remains constant throughout the term of the underlying loan. A more traditional approach to MRP is to set aside the same proportion of the loan each year. The saving generated from the use of the annuity method has enabled higher expenditure on services than would otherwise have been possible, but results in lower levels of cash balances which in turn means as capital expenditure takes place any borrowing requirement needs to be met by more external debt.

1.9. The Department for Communities & Local Government have issued a consultation on proposed changes to the prudential framework; this closed in December 2017 but the outcome is not known at the date of production of this Strategy. The current proposal is to restrict the number of years over which provision is made to 50 years for land and 40 years for other assets. The Council's MRP policy may need to be revised once the revised framework is published.

1.10. The CFR is increased when capital expenditure is financed by borrowing and is reduced when provision is made by way of MRP. The relationship between the MRP provision made each year and the extent of internal borrowing needed is a key component in determining whether the authority's liquidity (cash) is increasing or reducing.

1.11. Unuseable reserves fund working capital, external investments and the internal borrowing.

1.12. Recent investment in property funds has been facilitated largely by switching some of the internal borrowing to external borrowing. This has reduced the amount by which Medway is under borrowed. As with all investment returns are not guaranteed and the value of the investments may fall as well as rise. Members need to be comfortable that the expected additional returns warrant the level of risk undertaken.

Reporting requirements

1.13. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

1.13.1. Prudential and treasury indicators and treasury strategy (this report): The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

1.13.2. A mid-year treasury management report: This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

1.13.3. An annual treasury report: This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.14. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

Treasury Management Strategy for 2018/19

1.15. The strategy for 2018/19 covers two main areas:

1.15.1. Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

1.15.2. Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

1.15.3. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.16. **Training**

1.16.1. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. The training needs of Members and of treasury management officers are periodically reviewed.

1.17. **Treasury management consultants**

1.17.1. The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

1.17.2. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

1.17.3. 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.

The Prudential and Treasury Indicators 2018/19 – 2020/21

1.18. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans.

1.19. The Capital prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Due to uncertainties over future funding the Capital expenditure it is likely that these indicators will evolve as the budget setting process progresses. In particular the Council may provide loan financing to the recently formed Medway Development Company (MDCL). No decision has been made but any loans are likely to be classified as capital expenditure. The totals in the table below, also those in paragraph 1.20 as well as the capital financing requirement (CFR) and other ratios in Appendix 3 would be affected.

Capital Expenditure	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
C&A	12,255	6,648	5,450	4,856
RCET	24,819	18,218	6,636	6,564
BSD	148	20,000	0	0
Transformation	2,447	2,740	0	0
HRA	6,080	5,860	4,697	4,688
Total	**45,749**	**53,466**	**16,783**	**16,108**

1.20. The table below summarises how the expenditure plans are being financed. Schemes are funded from borrowing where other sources are not available.

Capital Funding	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Grants	20,921	19,581	12,161	10,049
S106	4,829	1,658	1,000	1,000
Receipts	2,238	0	0	164
Heritage Lottery	266	1,533	0	166
Reserves/RCCO	4,944	6,114	4,697	4,688
Borrowing	12,551	24,580	-1,075	41
Total	**45,749**	**53,466**	**16,783**	**16,108**

1.21. It is a statutory duty for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the authorised Limit represents the legislative borrowing limit.

1.22. The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

1.23. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in Appendix 3 of this report.

1.24. The Authorised Limit and Operational Boundary for external borrowing within Appendix 3 differentiate between external borrowing and "other long term liabilities". Other long term liabilities are other methods the authority has used to finance capital expenditure including embedded leases. Embedded leases are where we pay for the lease of equipment by our contractors, for example refuse collection. Currently our embedded leases account for £296,000. We have therefore set the Operational Boundary for other long term liabilities at £500,000 and £550,000 for Authorised Limit in 2018/19 as well as 2019/20 and 2020/21.

1.25. The Prudential and Treasury indicators are set out in Appendix 3 to this report and are relevant for the purposes of setting an integrated strategy.

Borrowing requirement

1.26. In recent years the Council has used available cash balances to fund capital expenditure in preference to taking new external borrowing. Principally, because of the profile of the capital programme, the cash flow position is now such that in order to maintain liquidity we will need to take out external borrowing to manage our cash flow over the medium term.

1.27. It is envisaged, subject to revisions in the capital programme, that borrowing will have increased by £43.0m over the course of 2017/18, remain broadly static during 2018/19 but reduce by about £4m in each of the years 2019/20 and 2020/21.

Borrowing strategy

1.28. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

1.29. Short term borrowing rates and investment returns are very low and are expected to remain so for the medium term. Subject to factors outlined above, borrowing requirements will be met by use of short term loans. This approach minimises net cost of financing as it avoids the cost of carrying large cash balances which would need to be invested for a lower return than the borrowing cost.

Prospects for Interest Rates

1.30. The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following gives Capita Asset Services' central view:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

1.31. As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

1.32. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

1.33. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

1.34. From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

1.35. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

1.36. The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit. The downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

1.37. The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world

Investment and borrowing rates

1.38. Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

1.39. Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

1.40. There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Current portfolio position

1.41. The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2017/18	2018/19	2019/20	2020/21
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£'000	£'000	£'000	£'000
External debt				
Debt at 1 April	202,093	245,093	265,969	260,497
Other long-term liabilities (OLTL) at 1 April	298	0	0	0
Expected change in Debt	43,000	20, 876	(5,472)	(4,220)
Expected change in OLTL	(298)	0	(0)	(0)
Expected gross debt at 31 March	245.093	265,969	260,497	256,277
The Capital Financing Requirement	265,505	286,381	280,909	276,689
Under borrowing	20,412	20,412	20,412	20,412

1.42. The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce size of the external debt position. However large premiums would be incurred by such action and make this course of action unattractive in the short term. This situation will be monitored in case the position changes.

1.43. The Council awaits the outcome of the objection to the 2015-16 Statement of Accounts relating to the LOBO loans. In the meantime exploratory discussions with lenders have indicated that early repayment would be prohibitively expensive. Unless the situation changes the current intention is to hold these debts until maturity.

1.44. The general aim of this treasury management strategy is to optimise treasury management performance, recognising that there is little opportunity to restructure long term debt, and therefore a need to maximise investment returns whilst adhering to the core principles of security, liquidity, and only then, yield.

1.45. The updated 2017-18 Strategy recognises the opportunities presented by the current economic conditions as characterised by low interest rates.

1.46. Bank rate is not expected to rise until 2019 and this supports the strategy to resist long-term borrowing, as over the next three years, investment rates are expected to remain below long-term borrowing rates.

1.47. Against this background caution will be adopted with the 2017-18 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances with decisions reported within the reviews of this strategy.

1.48. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017-18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

1.49. The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Debt Rescheduling

1.50. As short-term borrowing rates will be considerably cheaper than longer-term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

1.51. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

1.52. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

1.53. Decisions related to rescheduling will similarly be reported in reviews of this strategy.

Annual Investment Strategy

1.54. **Investment Policy**

1.54.1. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then the return.

1.54.2. In accordance with guidance from CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are Short Term and Long Term ratings.

1.54.3. Ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

1.54.4. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

1.54.5. Investment instruments identified for use in the financial year are listed in Appendix 5 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

1.55. **Creditworthiness policy**

1.55.1. This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moodys and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

1.55.2. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow – 5 years
- Purple – 2 years
- Blue – 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange – 1 year

- Red – 6 months
- Green – 100 days
- No Colour – not to be used

1.55.3. The Link Asset Services creditworthiness service uses a wider array of information than just primary. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

1.55.4. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1, a Long Term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

1.55.5. All credit ratings will be monitored, primarily via Link Asset Services updates, by Officers on a continuous basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

1.55.6. Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support for banks to help support its decision making process.

1.56. Counterparty Limits

1.56.1. The current counterparty limits are set as;

- In-house team £20 million limit per counterparty and £25 million for counterparties with a Link Asset Services duration rating of 12 months or above.

1.56.2. No amendments are requested to these counterparty limits.

1.57. Country limits

1.57.1. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5. This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

1.57.2. In addition:

- no more than £40m will be placed with any non-UK country at any time;
- limits in place will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

1.58. **Investment Strategy**

1.58.1. In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

1.58.2. Investment returns expectations. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

1.58.3. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	2.00%
Later years	2.75%

1.58.4. The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

1.59. **Investment in Property Funds**

1.59.1. Property Funds are a form of investment, comprising a portfolio of commercial properties to achieve investment returns through rental income and capital growth. However, the value of such investments may fall as well as rise. There may also be restrictions on redemption of the investment. This type of investment is regarded as a 5 to 7 year minimum timeframe.

1.59.2. Due diligence was undertaken before the Council invested in the CCLA Property Fund and the CFO would carefully consider the Council's cash balances and cashflow projections before investing further amounts.

1.60. **Investment in Money Market Funds**

1.60.1. Money Market Funds (MMFs) often offer enhanced returns compared with bank call accounts while reducing bail- in risk through diversification. Members approved the use of MMFs as part of the Council's investment portfolio and officers will consider their use when returns are considers to be attractive.

1.61. **End of year investment report**

1.61.1. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Kent County Council (KCC) Local Government Reorganisation (LGR) Debt

1.62. The charge for the share of KCC debt for which Medway Council was responsible on local government reorganisation is based on the current average cost of debt for the County Council as a whole. Whilst the County rate at a projected 4.959% remains marginally higher than our own average long- term debt rate of 4.218% for 2017/18, the penalty involved in early repayment makes early redemption an unattractive option. The outstanding principal at 1 April 2018 will be £35.4 million.

Minimum Revenue Provision (MRP)

1.63. The Minimum Revenue Provision is explained and the Policy Statement for 2018/19 is set out at Appendix 1.

1.64. An annuity method of allocating amounts of MRP to each year of asset life was adopted with effect from 2015/16. This works in a similar way to a repayment mortgage where the principal repaid in the early years is small but grows proportionally towards the end of the repayment period. Similarly the amount of MRP under this method starts with a small level of provision and rises over the life of the assets.

Appendix 1 – Minimum Revenue Provision Policy Statement 2018/19

1. In setting the Minimum Revenue Provision Policy, Medway Council has regard to the Minimum Revenue Provision (MRP) guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.
2. MRP is calculated on an annuity basis over the estimated lives of assets funded from debt.
3. The Council will treat all expenditures as not ranking for MRP until the year after the scheme or asset to which they relate is completed and/or brought into use.
4. Estimated life periods will be determined under delegated powers.
5. As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
6. In the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements (such as long term investments), or where borrowing has occurred but will be repaid by future Capital Receipts or agreed income from other source, there will be no Minimum Revenue Provision made.
7. There is no requirement on the HRA to make a minimum revenue provision, though in the interests of prudence the council has opted to do so.

Appendix 2 – Interest Rate Forecasts 2017-2021

PWLB rates below have taken into account the 20 basis points certainty rate reduction.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Bank Rate															
	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
Capital Economics	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	-	-	-	-	-
5yr PWLB Rate															
	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	1.57%	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.57%	1.70%	1.90%	2.30%	2.60%	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-
10yr PWLB Rate															
	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.10%	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.10%	2.30%	2.60%	2.80%	3.10%	3.30%	3.30%	3.30%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate															
	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.69%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.69%	2.95%	3.15%	3.45%	3.65%	3.90%	3.90%	3.90%	3.90%	3.90%	-	-	-	-	-
50yr PWLB Rate															
	NOW	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.41%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.41%	2.80%	3.10%	3.30%	3.60%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

Appendix 3 – Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2018/2019	2019/2020	2020/2021
Extract from budget and rent setting report	**Estimate** **£'000**	**Estimate** **£'000**	**Estimate** **£'000**
Capital Expenditure			
Non - HRA	47,606	12,086	11,420
HRA	5,860	4,697	4,688
TOTAL	53,466	16,783	16,108
Ratio of financing costs to net revenue stream			
Non - HRA	6.25%	6.75%	5.27%
HRA	10.41%	10.40%	10.30%
Gross borrowing requirement			
brought forward 1 April	245,093	245,969	260,497
carried forward 31 March	265,969	260,497	256,277
in year borrowing requirement	20,876	(5,477)	(4,220)
Capital Financing Requirement as at 31 March			
Non – HRA	243,877	238,731	234,851
HRA	42,504	42,178	41,838
TOTAL	286,381	280,909	276,689
Annual change in Cap. Financing Requirement			
Non – HRA	29,485	(5,146)	(3,880)
HRA	564	(326)	(340)
TOTAL	30,049	(5,472)	(4,220)
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase/ (decrease) in council tax (band D) per annum	10.38	9.18	(29.02)
Increase/ (decrease) in average housing rent per week	(0.26)	(0.11)	(0.18)

TREASURY MANAGEMENT INDICATORS	2018/2019	2019/2020	2020/2021
	Estimate	Estimate	Estimate
	£'000	£'000	£'000
Authorised Limit for external debt -			
Borrowing	425,019	397,511	414,358
other long term liabilities	550	550	550
TOTAL	425,569	419,550	414,908
Operational Boundary for external debt -			
Borrowing	386,381	380,909	376,689
other long term liabilities	500	500	500
TOTAL	386,881	381,409	377,189
Estimated actual external debt (31 March)	265,969	260,597	256,277
HRA Maximum CFR Debt Limit	45,846	45,846	45,846
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	425,569	419,550	414,908
Net Principal fixed Rate investment	50,000	50,000	50,000
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments (excluding LOBOs)	100,000	100,000	100,000
LOBO Limit	102,000	102,000	102,000
Upper limit for total principal sums invested for over 1 year			
(per maturity date)	£150,000	£150,000	£150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2017/2018	**upper limit**	**lower limit**
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

Appendix 4 – Specified and Non-specified Investments

SPECIFIED INVESTMENTS: (All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house and Fund Manager
Term deposits – local authorities	--	In-house and Fund Manager
Term deposits – banks and building societies	See note 1	In-house and Fund Manager
Collateralised deposit (see note 3)	UK sovereign rating	In-house and Fund Manager
Certificates of deposit issued by banks and building societies	See note 1	In-house and Fund Manager
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AAA	In-house buy and hold and Fund Manager
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Manager
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold and Fund Manager
Treasury Bills	UK sovereign rating	In house and Fund Manager
Government Liquidity Funds	* Long-term AAA volatility rating V1+	In-house and Fund Managers
Money Market Funds CNAV, LVNAV or VNAV	* Long-term AAA volatility rating V1+	In-house and Fund Managers

Note 1. Award of "Creditworthiness" Colour by Link Asset Services as detailed in paragraph 1.55.2.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of 70% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	*** Minimum Credit Criteria**	**Use**	**** Max total investments**	**Max. maturity period**
Fixed term deposits with variable rate and variable maturities: -Structured deposits	See note 1	In-house	£10m	Lower of 5 years or Sector duration rating
Property Funds	See note 2	In-house	£25m (original cost of investment)	N/A

2. Maturities in excess of 1 year

	*** Minimum Credit Criteria**	**Use**	**** Max total investments**	**Max. maturity period**
Term deposits – local authorities	--	In-house	£25m	5 Years
Term deposits – banks and building societies	See note 1	In-house	£25m	As per Capita duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1 and 2	In-house	£25m	As per Capita duration rating and see note 3
Certificates of deposit issued by banks and building societies	See note 1 and 2	In-house	£25m	As per Capita duration rating and see note 3
UK Government Gilts	UK sovereign rating	In-house	£25m	see note 1
Bonds issued by multilateral development banks	AAA	In-house	£10m	see note 1
Sovereign bond issues (other than the UK govt)	AAA	In-house	£10m	see note 1

Note 1. Award of “Creditworthiness” Colour by Link Treasury services as detailed in paragraph 1.55.2

Note 2 Property Funds are not credit rated.

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

Appendix 5 – Approved countries for investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A

AA

- Abu Dhabi (UAE)
- France
- ~~Qatar~~
- U.K

AA-

- Belgium
- Qatar

Appendix 6 – Amendments to the Treasury Management Practices

The following principal changes have been made to the TMPs compared with those published in January 2017:

Treasury Management Practice 1: Treasury Risk Management:

- TMP 1.11 The list of counterparties falling into each credit rating category has been updated.
- TMP 1.26 Approved interest rate exposures have been expressed as absolute monetary amounts rather than proportions.
- TMP 1.23 Comment added on interest rate risk arising from use of short term loans.
- TMO 1.44 Comment added on refinancing regarding the use of short term loans.

Treasury Management Practice 5: Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements:

- TMP 5.3 Structure chart updated.
- TMP 5.4 Principal Accountant added to list of officers with power to borrow and invest as delegated by the Chief Finance Officer.
- TMP 5.8 Policy on use of brokers to be based on terms offered rather than strict rotation of brokers used.