
Treasury Management Strategy

Medway Council
2020-21

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1. 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 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 1.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.
- 1.5 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.
- 1.6 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."

2. Reporting requirements

2.1 Capital Strategy

- 2.1.1 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, which will provide the following:
 - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
 - an overview of how the associated risk is managed
 - the implications for future financial sustainability

- 2.1.2 The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
- 2.1.3 This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
- The corporate governance arrangements for these types of activities;
 - Any service objectives relating to the investments;
 - The expected income, costs and resulting contribution;
 - The payback period (MRP policy);
 - For non-loan type investments, the cost against the current market value;
 - The risks associated with each activity.
- 2.1.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.
- 2.1.5 Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.
- 2.1.6 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.
- 2.1.7 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.
- 2.2 Treasury Management Reporting**
- 2.2.1 Alongside the Capital Strategy 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.
- 2.2.2 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).
- 2.2.3 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.
- 2.2.4 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.

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

3. Treasury Management Strategy for 2020/21

- 3.1 The strategy for 2020/21 covers two main areas:

3.2 Capital issues

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

3.3 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.

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

3.5 Training

- 3.5.1 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.

3.6 Treasury management consultants

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

- 3.6.2 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. All decisions will be undertaken with regards to all available information including, but not solely, our treasury advisors.

- 3.6.3 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.

3.7 The Capital Prudential and Treasury Indicators 2020/21 – 2022/23

- 3.7.1 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.

3.7.2 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.

Table 1: Capital Programme 2019/20

Expenditure	2019/20 £000s	2020/21 £000s	2021/22 £000s	2022/23 £000s	Total £000s
Children and Adult Services	6,936	26,164	0	0	33,100
Regeneration, Culture, Environment and Transformation	38,556	26,323	5,444	729	71,052
Housing Revenue Account	7,106	4,165	0	0	11,271
Business Support	73,972	50,471	37,280	18,355	180,078
Member Priorities	366	0	0	0	366
Total Expenditure	126,936	107,123	42,724	19,084	295,867
Prudential borrowing	53,332	59,520	0	0	112,852
Borrowing in lieu of capital receipts	31,197	37,939	37,380	18,910	125,426
Capital receipts	3,486	700	70	87	4,343
Right to Buy receipts	341	894	0	0	1,235
Grants	25,947	6,734	5,274	87	38,042
Developer Contributions	5,195	1,336	0	0	6,531
Revenue/ Reserves	7,439	0	0	0	7,439
Total Funding	126,936	107,123	42,724	19,084	295,867

4. Borrowing

4.1 The Council's borrowing need (the Capital Financing Requirement)

4.1.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue of capital resource, will increase the CFR.

4.1.2 The CFR does not increase indefinitely, as the minimum revenue provision is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

4.1.3 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £63,000 of such schemes within the CFR.

4.1.4 Members are asked to approve the CFR projections overleaf:

	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
CFR – non housing	292,930	387,700	423,334	442,613
CFR – housing	41,182	43,871	45,617	45,248
CFR – Commercial activities/ non-financial investments	20,000	20,000	20,000	20,000
Total CFR	354,112	451,571	488,951	507,861
Movement in CFR	84,529	97,459	37,380	18,910

4.1.5 Movement in CFR represented by:

	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
Net Financing need for the year (above)	84,529	97,459	37,380	18,910
Less MRP/VRP and other financing movements	-4,107	-3,878	-3,915	-3,809
Add back previous overprovision of MRP	4,107	3,878	3,915	3,809
Movement in CFR	84,529	97,459	37,380	18,910

4.1.6 A review of MRP undertaken by our treasury advisors revealed an over-provision had made over a number of years. MRP is therefore being offset by the over-provision from 2019/20 onwards.

4.1.7 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 1.23 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

4.1.8 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.

4.1.9 It is envisaged, subject to revisions in the capital programme, that external borrowing will have increased by £59.5m over the course of 2019/20, £97.4m in 2020/21, £37.3m in 2021/22 and £18.9m in 2022/23.

4.2 Borrowing strategy

4.2.1 The capital expenditure plans set out in Table 1 (Paragraph 3.7.2 above) provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organized in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organization of the cash flow and, where capital plans require the organization of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

4.2.2 Current portfolio position – The overall treasury management portfolio as at 31 March 2019 and the position as at 10 December 2019 is shown below for both borrowing and investment.

TREASURY PORTFOLIO				
	31 Mar 19 Actual £000	31 Mar 19 Actual %	10 Dec 19 Current £000	10 Dec 19 Current %
Treasury Investments				
Banks	1,295	3.1	22,693	43.1
Money Market Funds	6,909	16.8	6,939	13.2
UK Local Authorities	10,000	24.3	0	0
Total Managed In House	18,204	44.2	29,632	56.3
Externally Managed – Property Funds (at cost)	22,999	55.8	22,999	43.7
Total Treasury Investments	41,203	100	52,631	100
Treasury External Borrowing				
Charities	54	0	29	0
Local Authorities	50,000	20.3	33,000	12.2
PWLB	85,524	34.9	128,524	47.3
LOBOs	101,800	41.5	101,800	37.5
Growing Places, SALIX & SELEP	7,956	3.2	7,956	2.9
Total External Borrowing	245,334	100	271,309	100
Net Borrowing	204,131		218,678	

4.2.3 The Council's forward projections for borrowing are summarized below. The table shows the actual external debt against the underlying capital borrowing need, (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

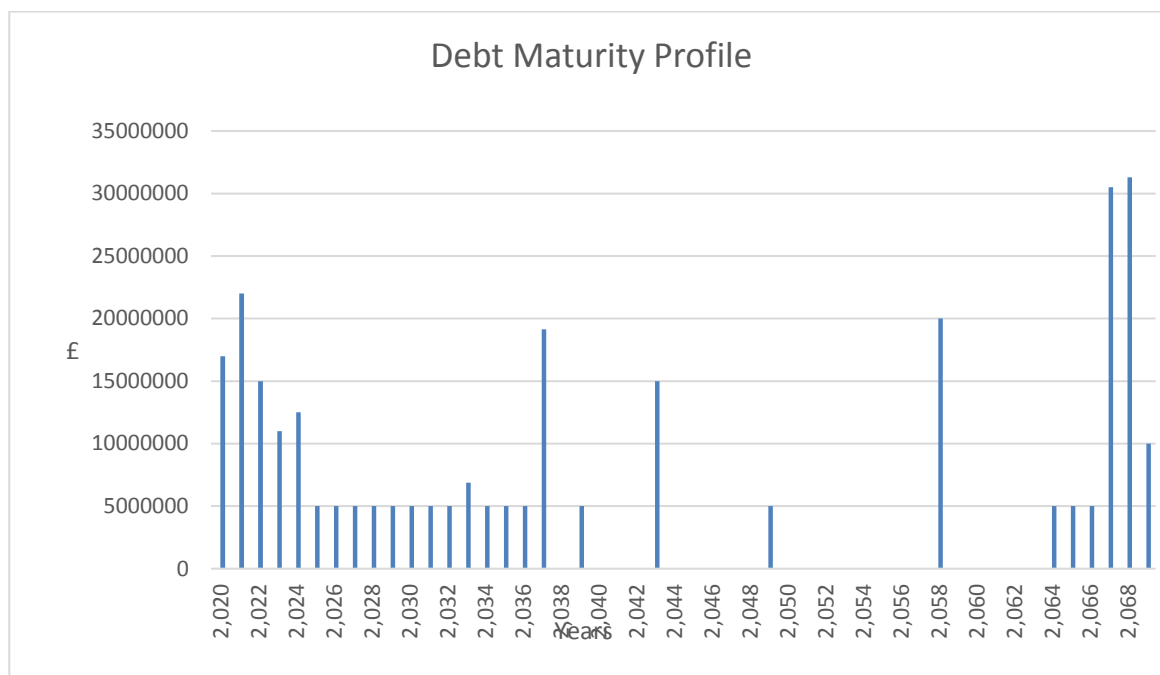
	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
Debt at 1 April	242,300	301,829	399,288	436,668
Expected Change in Debt	59,529	97,459	37,380	18,910
Expected Gross Debt at 31 March	301,829	399,288	436,668	455,578
Capital Financing Requirement 31 March	354,112	451,571	488,951	507,861
Under/ (over) borrowing	52,283	52,283	52,283	52,283

4.2.4 Within the above figures the level of debt relating to commercial activities / non- financial investment is:

	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
Estimated Debt for Commercial Activities	20,000	20,000	20,000	20,000
Percentage of total external debt %	6.6	5.0	4.5	4.4

4.2.5 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

4.2.6 The repayment dated for maturity loans is shown overleaf:



4.2.7 Officers aim to smooth out the maturity profile and reduce reliance on short term borrowing but will seek to hold some short term debt to manage cash flow. The recent rise in rates by PWLB, the main source of longer term borrowing, has led to a renewed borrowing at shorter dates in recent months.

4.3 New financial institutions as a source of borrowing and / or types of borrowing

4.3.1 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

4.3.2 The degree to which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

4.4 Treasury Indicators: limits to borrowing activities

4.5 The Operational Boundary

4.5.1 This is the limit beyond which external debt is not normally expected to exceed. In most cases this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources. (Table overleaf).

Operational Boundary	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
Debt	434,112	531,571	568,951	587,861
Other long term liabilities	500	500	500	500
Commercial activities/ non-financial investments	20,000	20,000	20,000	20,000
Total	454,612	552,071	589,451	608,361

4.6 The authorised limit for external debt.

4.6.1 This is a key prudential indicator and represents a control on the maximum level of borrowing. It is a legal limit, determined under S3(1) of the Local Government Act 2003, beyond which external borrowing is prohibited, and this limit needs to be set or revised by full Council. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Authorised Limit	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s
Debt	477,524	584,728	625,846	646,647
Other long term liabilities	550	550	550	550
Commercial activities/ non-financial investments	22,000	22,000	22,000	22,000
Total	500,074	607,278	648,396	669,197

Upper Limit for Fixed Interest Rate Exposure	2019/20 £000s	2020/21 £000s	2021/22 £000s	2022/23 £000s
Net principal fixed rate borrowing	500,074	607,278	648,396	669,197
Net principal fixed rate investment	50,000	50,000	50,000	50,000

Upper Limit for Variable Rate Exposure	2019/20 £000s	2020/21 £000s	2021/22 £000s	2022/23 £000s
Net principal investment/borrowing (excluding LOBOs) at variable rate	100,000	100,000	100,000	100,000
LOBO limit	102,000	102,000	102,000	102,000

Maturity Structure of Fixed rate Borrowing during 2020/21	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%

4.6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. 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.*

4.7 Policy on borrowing in advance of need

4.7.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

4.7.2 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

4.8 Prospects for Interest Rates

4.8.1 The Council has appointed Link 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 but was prepared before the result of the December 2019 general election (see overleaf):

Link Asset Services Interest Rate View														
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

- 4.8.2 The above forecasts have been based on an assumption that there is some sort of muddle through to an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. Given the current level of uncertainties around the result of the general election due on 12 December and then subsequent developments, this is a major assumption and so forecasts may need to be materially reassessed in the light of events over the coming weeks or months.
- 4.8.3 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and more recently, due to the impending general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy, if Brexit uncertainties were to become more entrenched, and also for weak global economic growth: if those uncertainties were to materialise, then it was likely the MPC would cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were an eventual Brexit with no agreement on the terms of trade between the UK and EU, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.
- 4.8.4 Bond yields / PWLB rates – There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.
- 4.8.5 During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of

100bps introduced on 9.10.19.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this and how strong the correlation is likely to be is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

- 4.8.6 One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.
- 4.8.7 Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.
- 4.8.8 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. 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, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 4.8.9 In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.
- 4.8.10 Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. 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.

4.9 Investment and borrowing rates

- 4.9.1 Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- 4.9.2 Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running

down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.

4.9.3 While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

4.9.4 Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years. 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; will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

4.10 Debt Rescheduling

4.10.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

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

5. Investment

5.1 Annual Investment Strategy

5.1.1 Investment policy – management of risk

5.1.2 The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

5.1.3 The Council’s investment policy has regard to the following: -

- MHCLG’s Guidance on Local Government Investments (“the Guidance”)
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2018
- The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).

5.1.4 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

5.1.5 Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

5.1.6 Other information: ratings will not be the sole determinant of the quality of an institution; 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 achieve this consideration 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.

- 5.1.7 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.
- 5.1.8 This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in appendix 5 under the categories of ‘specified’ and ‘non-specified’ investments.
- 5.1.9 Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
- 5.1.10 Non- specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
- 5.1.11 Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in Treasury Management Practice 1, paragraph 1.12.
- 5.1.12 Transaction limits are set for each type of investment in appendix 4.
- 5.1.13 This authority will set a limit for the amount of its investments which are invested for longer than 365 days, (see appendix 4).
- 5.1.14 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see appendix 4).
- 5.1.15 This authority has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
- 5.1.16 All investments will be denominated in sterling.
- 5.1.17 As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)
- 5.1.18 However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

5.2 Creditworthiness policy

- 5.2.1 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:

- 5.2.2 credit watches and credit outlooks from credit rating agencies;
- 5.2.3 CDS spreads to give early warning of likely changes in credit ratings;
- 5.2.4 Sovereign ratings to select counterparties from only the most creditworthy countries.
- 5.2.5 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 *
 - Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
 - Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
 - 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
- 5.2.6 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.
- 5.2.7 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.
- 5.2.8 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.
- 5.2.9 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.
- 5.2.10 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.
- 5.2.11 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.

5.3 Counterparty Limits

- 5.3.1 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.

5.3.2 No amendments are requested to these counterparty limits.

5.4 Country limits

5.4.1 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.

5.4.2 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.

5.5 Investment Strategy

5.5.1 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).

5.5.2 Officers will aim to minimise net cash balances by appropriate uses of short term borrowing such that as cash balances surplus to immediate needs arise they are quickly matched by the opportunity to repay maturing debt.

5.6 Investment in Property Funds

5.6.1 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.

5.6.2 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.

5.7 Loans to Social Enterprises and Similar Organisations

5.7.1 Medway will consider advancing funds to organisations where the purpose of such loans advances Council priorities.

5.8 Investment in Money Market Funds

5.8.1 Money Market Funds (MMFs) often offer enhanced returns compared with bank call accounts while reducing bail- in risk through diversification. Investment has been made in a MMF operated by CCLA and officers with consider making similar investments in other MMFs.

5.8.2 Investment treasury indicator and limit – total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Upper limit for principal sums invested for longer than 365 days			
	2020/21 £m	2021/22 £m	2022/23 £m
Principal sums invested for longer than 365 days	150	150	150
Current Investments as at 17.12.19 in excess of 1 year maturing each year	0	0	0

5.9 End of year investment report

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

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

- 6.1 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 4.581% remains higher than our own average long- term debt rate of 3.6% for 2017/18, the penalty involved in early repayment makes early redemption an unattractive option. The outstanding principal at 1 April 2020 will be £32.67 million.

7. Minimum Revenue Provision (MRP)

- 7.1 The Minimum Revenue Provision is explained and the Policy Statement for 2020/21 is set out at Appendix 1.
- 7.2 As noted in paragraph 4.1.6 above a review of MRP undertaken by our treasury advisors revealed an over-provision had made over a number of years. MRP is therefore being offset by the over-provision from 2019/20 onwards.

Appendix 1 – Minimum Revenue Provision Policy Statement 2020/21

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.

MRP is calculated on an annuity basis over the estimated lives of assets funded from debt. The period over which provision is made for all expenditure after 1 April 2018 is subject to an upper limit of 50 years in line with the latest MHCLG guidance. MRP on expenditure prior to 1 April 2018 is provided over the remaining life previously estimated.

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.

Estimated life periods will be determined under delegated powers.

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.

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.

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 2019-2022

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

Bank Rate															
	NOW	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Link Asset Services	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	-	-	-	-	-
5yr PWLB Rate															
	NOW	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Link Asset Services	1.77%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	1.77%	2.00%	2.00%	2.20%	2.40%	2.70%	2.70%	2.80%	2.80%	2.90%	-	-	-	-	-
10yr PWLB Rate															
	NOW	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Link Asset Services	2.19%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.19%	2.30%	2.40%	2.60%	2.80%	3.10%	3.10%	3.10%	3.10%	3.10%	-	-	-	-	-
25yr PWLB Rate															
	NOW	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Link Asset Services	2.79%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.79%	2.80%	3.00%	3.10%	3.30%	3.60%	3.50%	3.50%	3.40%	3.40%	-	-	-	-	-
50yr PWLB Rate															
	NOW	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Link Asset Services	2.66%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.66%	2.70%	2.80%	2.90%	3.20%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

Appendix 3 – Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2019/2020	2020/2021	2021/2022	2022/2023
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
Capital Expenditure				
Non - HRA	119,830	102,958	42,724	19,084
HRA	7,106	4,165	0	0
TOTAL	126,936	107,123	42,724	19,084
Ratio of financing costs to net revenue stream				
Non - HRA	5.50%	6.16%	6.50%	6.43%
HRA	12.38%	12.43%	12.74%	12.60%
Gross borrowing requirement				
brought forward 1 April	253,517	336,046	428,505	465,885
carried forward 31 March	336,046	428,505	465,885	484,795
in year borrowing requirement	82,529	92,459	37,380	18,910
Capital Financing Requirement as at 31 March				
Non – HRA	292,930	387,700	423,334	442,613
Commercial/ Non-Financial	20,000	20,000	20,000	20,000
HRA	41,182	43,871	45,617	45,248
TOTAL	354,112	451,571	488,951	507,861
Annual change in Cap. Financing Requirement				
Non – HRA	84,675	94,770	35,636	19,279
Commercial/ Non-Financial	0	0	0	0
HRA	-146	2,689	1,746	-369
TOTAL	84,529	97,459	37,380	18,910

TREASURY MANAGEMENT INDICATORS	2019/2020	2020/2021	2021/2022	2022/2023
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
Authorised Limit for external debt -				
Borrowing	477,524	584,728	625,846	646,647
Other long term liabilities	550	550	550	550
Commercial activities/ non-financial investments	22,000	22,000	22,000	22,000
TOTAL	500,074	607,278	648,396	669,197
Operational Boundary for external debt -				
Borrowing	434,112	531,571	568,951	587,861
Other long term liabilities	500	500	500	500
Commercial activities/ non-financial investments	20,000	20,000	20,000	20,000
TOTAL	454,612	552,071	589,451	608,361
Estimated actual external debt (31 March)	301,829	399,288	436,668	455,578
Upper limit for fixed interest rate exposure				
Net principal re fixed rate borrowing	500,074	607,278	648,396	669,197
Net Principal fixed Rate investment	50,000	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	100,000
LOBO Limit	102,000	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	150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2020/2021	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 Link 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 Link 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 Link 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 Link 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
Social Enterprises	See note 3	In House	£5m	25 years

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

Note 2 Property Funds are not credit rated.

Note 3 Social Enterprises may not be 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
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- 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 2019:

Treasury Management Practice 1: Treasury Risk Management:

- TMP 1.6 the of Link Asset Services colour ratings for risk analysis has been updated
- TMP 1.2.4 the overall borrowing limit has been updated in line with the authorised limit for 2020/21
- TMP 1.33a The job title 'Principal Accountant' has been replaced by @Finance Business Partner'
- TMP 1.33c Finance business Partner has been added as an officer able to authorise borrowing for periods in excess of 365 days
- TMP 1.6.1 list of guidance and codes of practice updated
- TMP 10.9 job titles and qualifications of treasury staff updated
- TMP 11.7 Imperial Treasury Services added to the list of approved broke