Treasury Management Strategy

Medway Council

2021-22

Contents

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 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.

2.2 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 progress report 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 backwards looking review 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 2021/22

3.1 The strategy for 2021/22 covers two main areas:

3.2 Capital issues

- the capital expenditure plans and the associated 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 Group, Treasury Solutions as its external treasury management advisors.

3.6.2 The Council recognises that responsibility for treasury management decisions remains with the 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 – 2023/24

3.7.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is 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 2020/21

Expenditure	**2020/21 £000s**	**2021/22 £000s**	**2022/23 £000s**	**2023/24 £000s**	**Total £000s**
Children and Adult Services	8,312	11,048	9,250	853	29,463
Regeneration, Culture, Environment and Transformation	33,822	64,579	89,657	50,935	238,993
Housing Revenue Account	12,290	12,306	461	0	25,057
Business Support	22,724	71,202	49,223	37	143,186
Member Priorities	0	323	0	0	323
Total Expenditure	**77,148**	**159,458**	**148,591**	**51,825**	**437,022**
Prudential borrowing	17,358	58,428	27,108	891	103,785
Borrowing in lieu of capital receipts	20,035	52,411	39,919	1,482	113,847
Capital receipts	3,750	1,735	959	123	6,567
Capital Grants	26,903	42,470	80,525	49,066	198,964
Right to Buy receipts	93	0	0	0	93
Developer Contributions	2,064	289	80	260	2,693
Revenue/ Reserves	6,945	4,125	0	3	11,073
Total Funding	**77,148**	**159,458**	**148,591**	**51,825**	**437,022**

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 or MRP (a statutory annual revenue charge) 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. embedded leases and finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £1.7m, of such schemes within the CFR.

4.1.4 Members are asked to approve the CFR projections overleaf:

	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
CFR – non housing	314,197	411,107	456,020	398,508
CFR – housing	46,017	53,790	53,825	53,381
Total CFR	360,214	464,897	509,845	451,889
Movement in CFR	36,770	104,683	44,948	(57,955)

4.1.5 Movement in CFR represented by:

	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
Prudential Borrowing	17,358	58,428	27,108	891
Less MRP/VRP and other financing movements	(4,976)	(5,490)	(7,159)	(7,917)
Add back previous overprovision of MRP	4,976	5,490	5,115	0
Borrowing in Lieu of Capital Receipts	20,035	52,411	39,919	1,482
Capital Receipts Repaying Borrowing	(623)	(6,156)	(20,035)	(52,411)
Movement in CFR	36,770	104,683	44,948	(57,955)

4.1.6 A review of MRP undertaken buy 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. It is estimated that total over-provision will have been applied in offsetting MRP by the end of 2022/23.

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. This Treasury Management Strategy Statement assumes that no further expenditure will be undertaken purely for commercial gain rather than in pursuit of the Council's regeneration objectives.

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 £36.8m over the course of 2020/21, £104.7m in 2021/22, £44.9m in 2022/23 but reducing by £57.9m in 2023/24.

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 2020 and the position as at 10 December 2020 is shown below for both borrowing and investment.

The table below displays the Treasury Portfolio.

Treasury Investments	31 Mar 20 Actual £000	31 Mar 20 Actual %	10 Dec 20 Current £000	10 Dec 20 Current %
Banks	40,665	58.45	21,406	27.32
UK Local Authorities	0	0.00	20,000	25.53
Total Managed In House	40,665	58.45	41,406	52.85
Externally Managed – Property Funds (at cost)	21,960	31.56	21,960	28.03
Money Market Funds	6,953	9.99	14,987	19.13
Total Treasury Investments	69,578	100.00	78,353	100.00

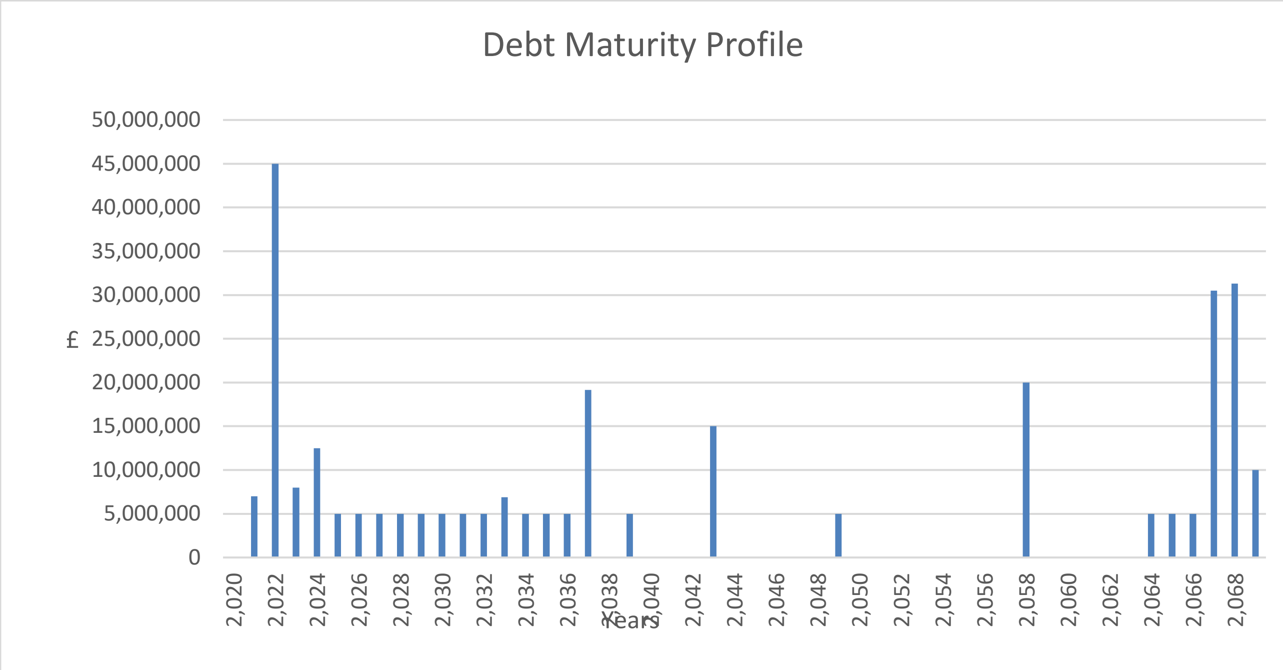
Treasury External Borrowing				
Local Authorities	60,000	20.29	60,000	20.64
PWLB	128,524	43.47	123,524	42.50
LOBOs	101,800	34.43	101,800	35.02
Growing Places, SALIX & SELEP	5,333	1.80	5,333	1.83
Total External Borrowing	295,657	100.00	290,657	100.00
Net Borrowing	226,079		213,304	

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.

	2020/21 Estimate £000s	**2021/22 Estimate £000s**	**2022/23 Estimate £000s**	**2023/24 Estimate £000s**
Debt at 1 April	295,657	332,427	437,110	484,102
Expected Change in Debt	36,770	104,683	46,992	(50,038)
Expected Gross Debt at 31 March	332,427	437,110	484,102	434,064
Capital Financing Requirement 31 March	360,214	464,897	509,845	451,889
Under/ (over) borrowing	27,787	27,787	25,743	17,825

4.2.4 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.

4.2.5 The repayment dated for maturity loans is shown below:



4.2.6 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. However for much of 2019/20 PWLB interest rates were not attractive and more short-term funding was used, which explains the spike in debt maturing in 2021/22. Following a government consultation PWLB rates have been reduced again and much of the short-term borrowing will be re-financed by longer term PWLB loans.

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

4.3.1 As an alternative to PWLB consideration will be given to the following sources:

- 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 Before any of these sources is used for long term funding officers will consult with our treasury advisors, Link.

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 below).

Operational Boundary	2020/21 Estimate £000s	2021/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
Debt	460,214	564,897	609,845	551,880
Other long-term liabilities	2,000	2,000	2,000	2,000
Total	462,214	566,897	611,845	553,880

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	2020/21 Estimate £000s	2022/22 Estimate £000s	2022/23 Estimate £000s	2023/24 Estimate £000s
Debt	506,235	621,387	670,729	607,078
Other long-term liabilities	2,200	2,200	2,200	2,200
Total	508,435	623,587	672,929	609,278

Upper Limit for Fixed Interest Rate Exposure	2020/21 £000s	2021/22 £000s	2022/23 £000s	2023/24 £000s
Net principal fixed rate borrowing	508,435	621,387	672,929	609,278
Net principal fixed rate investment (excluding subsidiaries)	50,000	50,000	50,000	50,000
Net principal fixed rate loans to subsidiaries of Medway Council	100,000	100,000	100,000	100,000

Upper Limit for Variable Rate Exposure	2020/21 £000s	2021/22 £000s	2022/23 £000s	2023/24 £000s
Net principal investment/borrowing (excluding LOBOs) at variable rate	100,000	100000	100,000	100,000
LOBO limit	102,000	102,000	102,000	102,000

Maturity Structure of Fixed rate Borrowing during 2021/22	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 A new limit of £100m is proposed from 2020/21 for fixed rate loans to subsidiaries (see table above). The interest rate set on such loans will take account of market rates, the security offered, the risk of default, and the requirements to comply with State Aid rules.

4.6.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 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 Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11.8.20. However, following the conclusion of the review of PWLB margins over gilt yields on 25.11.20, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps.

Link Group Interest Rate View 9.11.20														
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

4.8.2 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

Gilt Yields/ PWLB rates

4.8.3 There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very 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. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 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.

4.8.4 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21. 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.

4.8.5 As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. 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, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

4.9 Investment and borrowing rates

4.9.1 Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

4.9.2 Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure: -

PWLB Standard Rate is gilt plus 200 basis points (G+200bps)

PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)

PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)

Local Infrastructure Rate is gilt plus 60bps (G+60bps)

4.9.3 As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

4.9.4 On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

PWLB Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)

PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)

Local Infrastructure Rate is gilt plus 60bps (G+60bps)

4.9.5 Borrowing for capital expenditure. As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. Short term borrowing is still likely to be cheaper but risks having to pay higher rates when re-financing.

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

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 4 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 Treasury Management Practice 1.

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 5).

5.1.15 This authority has engaged external consultants, (see paragraph 3.6), 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 2020/21 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 ending 31 March 2023.)

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. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's 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 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 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 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. 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 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.

5.7.2 The Council may also make loans or rolling credit facilities to its subsidiary companies.

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.

The table below details the Upper limit for principal sums invested for longer than 365 days

	2021/22 £m	2022/23 £m	2023/24 £m
Principal sums invested for longer than 365 days	150	150	150
Current Investments as at 11.12.20 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 4.579% for 2020/21 remains higher than our own average long- term debt rate, the penalty involved in early repayment makes early redemption an unattractive option. The outstanding principal at 1 April 2021 will be £31.36 million.

7. Minimum Revenue Provision (MRP)

7.1 The Minimum Revenue Provision is explained and the Policy Statement for 2021/22 is set out at Appendix 1.

7.2 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. On current estimates all of the over-provision will have been offset by 31 March 2023.

Appendix 1 – Minimum Revenue Provision Policy Statement 2021/22

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 2020-24

Link Group Interest Rate View 9.11.20										(The Capital Economics forecasts were done 11.11.20)				
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20														
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate														
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate														
Link	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate														
Link	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate														
Link	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate														
Link	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

The PWLB rates above are based on the new margins over gilts announced on 26th November 2020. PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Appendix 3 – Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2020/21 Estimate £'000	2021/2022 Estimate £'000	2022/2023 Estimate £'000	2023/2024 Estimate £'000
Capital Expenditure	N/A	N/A	N/A	N/A
Non - HRA	64,858	147,152	148,130	51,825
HRA	12,290	12,306	461	0
TOTAL	77,148	159.458	148,591	51,825
Ratio of financing costs to net revenue stream	N/A	N/A	N/A	N/A
Non - HRA	2.50%	3.37%	4.09%	N/a*
HRA	12.38%	12.43%	12.74%	12.60%
**Non HRA income stream for 22/23 not available*	N/A	N/A	N/A	N/A
Gross borrowing requirement	**£'000**	**£'000**	**£'000**	**£'000**
brought forward 1 April	295,657	332,427	437,110	484,102
carried forward 31 March	332,427	437,110	484,102	434,064
in year borrowing requirement	36,770	104,683	46,992	(50,038)
Capital Financing Requirement as at 31 March	N/A	N/A	N/A	N/A
Non – HRA	314,197	411,107	456,020	398,508
HRA	46,017	53,790	53,825	53,281
TOTAL	360,214	464,897	509,845	451,889
Annual change in Cap. Financing Requirement	N/A	N/A	N/A	N/A
Non- HRA	31,755	96,909	44,913	(57,512)
HRA	5,015	7,774	34	(443)
TOTAL	36,770	104,683	44,947	(57,955)

TREASURY MANAGEMENT INDICATORS	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's	2023/24 Estimate £000's
Authorised Limit for external debt	N/A	N/A	N/A	N/A
Borrowing	506,235	621,387	670,729	607,078
Other Long-term liabilities	2,200	2,200	2,200	2,200
TOTAL	508,435	623,587	672,929	609,278
Operational Boundary for external debt	N/A	N/A	N/A	N/A
Borrowing	460,214	564,897	609,845	551,880
Other long-term liabilities	2,000	2,000	2,000	2,000
TOTAL	462,214	566,897	611,845	553,880
Estimated actual external debt (31 March)	332,427	437,110	484,102	424,064

Upper limit for fixed interest rate exposure	N/A	N/A	N/A	N/A
Net principal re fixed rate borrowing	508,435	621,387	672,929	609,278
Net principal fixed rate investment (exc. Subsidiaries) Net principal fixed rate loans to subsidiaries of Medway Council	50,000 100,000	50,000 100,000	50,000 100,000	50,000 100,000
Upper limit for variable rate exposure	N/A	N/A	N/A	N/A
Net principal re variable rate borrowing / investments (excluding LOBOs) LOBO Limit	100,000 102,000	100,000 102,000	100,000 102,000	100,000 102,000
Upper limit for total principal sums invested for over 1 year	N/A	N/A	N/A	N/A
(per maturity date)	150,000	150,000	150,000	150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2021/2022	**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 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	N/A	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 paragraph 1.55.2

Note 2. Property Funds are not credit rated.

Note 3. Property Funds: up to an aggregate of £25m may be invested in collective property Funds (based on original cost of investment)

Note 4. 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
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- U.K.

Appendix 6 – Amendments to the Treasury Management Practices

The following principal changes have been made to the TMPs compared with those published in January 2020

Treasury Management Practice 1: Treasury Risk Management

- 1.11 table of countries and credit ratings updated in line with Appendix 5 above
- 1.24 reference to interest rate risk having been increased by policy of borrowing short term has been deleted as less short-term borrowing will be used in future
- 1.24 borrowing limits updated to reflect figures in this strategy
- 1.68 job title of monitoring officer updated

Treasury Management Practice 2: Performance Measurement

- 2.4 Principal Accountant replaced by Finance Business Partner – Corporate Services

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

- 5.5 Staff chart updated for borrowing and lending
- 5.5 Text amended to state that the Chief Finance Office will consider and decide on detailed proposals for borrowing and investment made by the Finance Business Partner – Corporate Finance
- 5.9 Finance Business Partner replaces Principal Accountant
- 6.8 The Annual Investment Strategy Statement no longer includes the budget for investment earnings so the reference to this budget has been deleted from the list in this paragraph

Treasury Management Practice 9: Money Laundering

- 9.6 & 9.7 The list of regulations has been updated
- 10.2 Finance Support Manager replaced by Head of Finance Strategy

Treasury Management Practice 11: Use of External Service Providers

- 11.11 Principal Accountant replaced by Finance Business Partner – Corporate Services
- 11.11 Note added that Link contract was extended to 28 February 2021