Treasury Management Strategy

Medway Council

2023-24

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 2021 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 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 Annual 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. In addition, this authority will receive quarterly update reports.

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 2023/24

3.1 The strategy for 2023/24 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, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and CIPFA Treasury Management Code.

3.5 Training

3.5.1 The CIPFA Treasury Management 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.

3.5.2 Furthermore, pages 47 and 48 of the Code state that they expect “all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

3.5.3 The scale and nature of this will depend on the size and complexity of the organisation's treasury management needs. Organisations should consider how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and board/council members.
- Require treasury management officers and board/council members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation).
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis."

3.5.4 In further support of the revised training requirements, CIPFA's Better Governance Forum and Treasury Management Network have produced a 'self-assessment by members responsible for the scrutiny of treasury management', which is available from the CIPFA website to download.

3.6 Treasury management consultants

3.6.1 The Council uses Link Group, Link Treasury Services Limited 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 Indicators 2023/24 – 2025/26

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 2022/23

Expenditure	2022/23 £000s	2023/24 £000s	2024/25 £000s	2025/26 £000s	Total £000s
Children and Adult Services	15,316	4,027	500	1,691	21,534
Regeneration, Culture and Environment	145,827	105,622	162,870	9,567	423,886
Housing Revenue Account	13,207	12,285	2,177	0	27,669
Business Support	638	83	0	3	724
Member Priorities	25	50	10	278	363
Less Overspends (pending funding decision)	0	-659	0	0	-659
Total Expenditure	**175,013**	**121,408**	**165,557**	**11,539**	**473,517**
Prudential borrowing	35,122	37,168	12,076	5,874	90,240
Borrowing in lieu of capital receipts	79,763	24,013	17,365	298	121,439
Borrowing in lieu of future business rates	17,962	3,425	4,241	4,675	30,303
Borrowing in lieu of future S106	187	987	0	0	1,174
Borrowing in lieu of future NHS Grant	4,000	6,348	0	0	10,348
Capital receipts	3,134	1,542	563	295	5,534
Capital Grants	22,508	40,355	131,211	137	194,211
Right to Buy receipts	2,151	3,068	0	0	5,219
Developer Contributions	2,671	714	0	260	3,645
Revenue/ Reserves	7,515	3,788	100	0	11,403
Total Funding	**175,013**	**121,408**	**165,556**	**11,539**	**473,517**

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 schemes include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council had £1.465m, of such schemes within the CFR at 31 March 2022.

4.1.4 Members are asked to approve the CFR projections:

	2021/22 Actual	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
CFR – non housing	371,770	483,434	491,382	432,897	406,328
CFR – housing	40,682	44,377	49,003	50,774	50,350
Total CFR	412,452	527,811	540,386	483,671	456,678
Movement in CFR	44,491	115,359	12,575	-56,715	-26,993

4.1.5 Movement in CFR represented by:

	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
Prudential Borrowing and borrowing in lieu of future business rates	53,085	40,593	16,317	10,550
Borrowing in lieu of future capital receipts	79,763	24,013	17,365	298
Borrowing in lieu of future S106	187	987	0	0
Borrowing in lieu of future NHS grant	4,000	6,348	0	0
Less MRP/VRP (net of offset) and other financing movements	-437	-5,799	-5,337	-5,428
Less KCC debt repayment	-1,204	-1,156	-1,110	-1,065
Less capital receipts repaying borrowing (2 year lag assumed)	-20,035	-52,411	-79,763	-24,013
Less repayment from S106 (2 year lag assumed)	0	0	-187	-987
Less repayment from NHS grant (2 year lag assumed)	0	0	-4000	-6,348
Movement in CFR	115,359	12,575	-56,715	-26,993

4.1.6 A review of MRP undertaken by our treasury advisors revealed an over-provision had been made over a number of years. MRP has therefore being offset by the over-provision from 2019/20, however this will be fully offset by the end of 2022/23.

4.1.7 It is envisaged, subject to revisions in the capital programme, that external borrowing will have increased by £115.3m over the course of 2022/23, £12.6m in 2023/24, but will reduce by £56.7m in 2024/25 and a further £27m in 2025/26.

4.2 **Liability Benchmark**

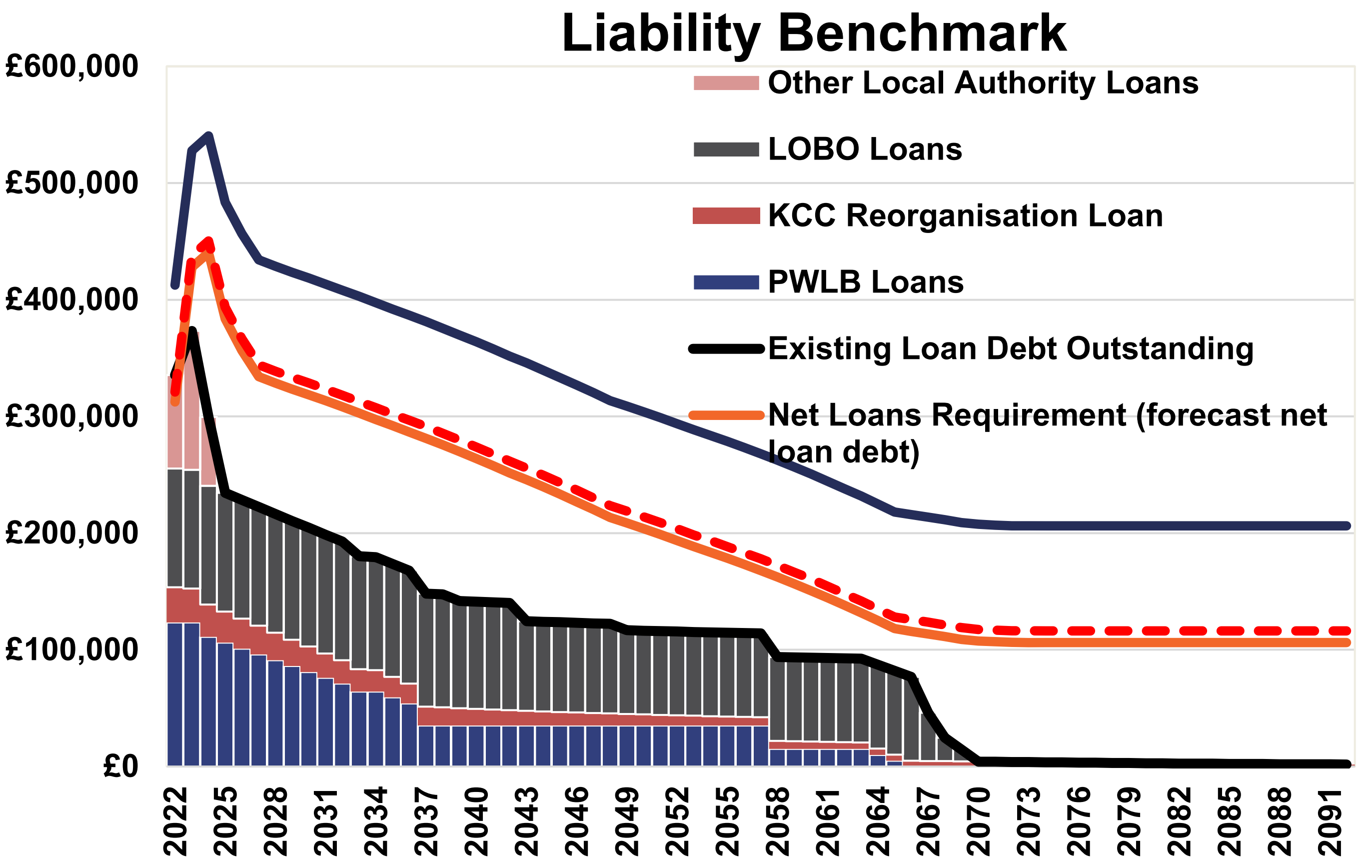
4.2.1 A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

4.2.2 There are four components to the liability benchmark:

- Existing loan debt outstanding: the Authority's existing loans that are still outstanding in future years (shaded areas at the bottom of the graph below)
- Loans CFR: this is calculated in accordance with loans CFR definition in the

Prudential Code and projected into the future based on approved prudential borrowing and planned MRP (dark blue line at the top of the graph)

- Net loan requirement: this will show the Authority's gross loan debt less treasury management investments at the last financial year end, projected into the future based on its approved prudential borrowing, planned MRP and other major cash flows forecast (orange line below the red dotted line)
- Liability benchmark (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance (red dotted line)



The graph shows that under current capital plans the Council will need to take out new loans in future as shown by the gap between the orange line and the shaded areas. The loan requirement is close to the liability benchmark as it is assumed that the Council needs only £10m as a day to day (liquidity) cash balance. At no point does the loan requirement exceed the CFR.

4.3 Borrowing strategy

4.3.1 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.

4.3.2 Current portfolio position – The overall treasury management portfolio as at 31 March 2022 and the position as at 13 December 2022 (including November 2022 valuation for property funds) is shown below for both borrowing and investment.

TREASURY PORTFOLIO				
	31 Mar 22 Actual £000	**31 Mar 22 Actual %**	**13 December 22 Current £000**	**13 December 22 Current %**
Treasury Investments				
Banks	8,416	9.60	14	0.01
Medway Council Subsidiaries	35,040	39.98	60,708	65.87
Total Managed In House	43,456	49.58	60,722	65.88
Externally Managed – Property Funds (at current value)	25,011	28.53	22,845	24.79
Money Market Funds	19,187	21.89	8,602	9.33
Total Treasury Investments	87,654	100.00	92,169	100.00
Treasury External Borrowing				
Local Authorities	80,000	26.20	131,500	38.14
PWLB	123,524	40.45	111,024	32.20
LOBOs	101,800	33.34	101,800	29.52
SALIX/SELEP	47	0.01	485	0.14
Total External Borrowing	305,371	100.00	344,809	100.00
Net Borrowing	217,717		252,640	

4.3.3 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.

	2022/23 Actual £000s	**2023/24 Estimate £000s**	**2024/25 Estimate £000s**	**2025/26 Estimate £000s**
Debt at 1 April	335,429	450,788	463,363	406,648
Expected Change in Debt	115,359	12,575	-56,715	-26,993
Expected Gross Debt at 31 March	450,788	463,363	406,648	379,655
Capital Financing Requirement 31 March	527,811	540,386	483,671	456,677
Under/ (over) borrowing	77,023	77,023	77,023	77,022

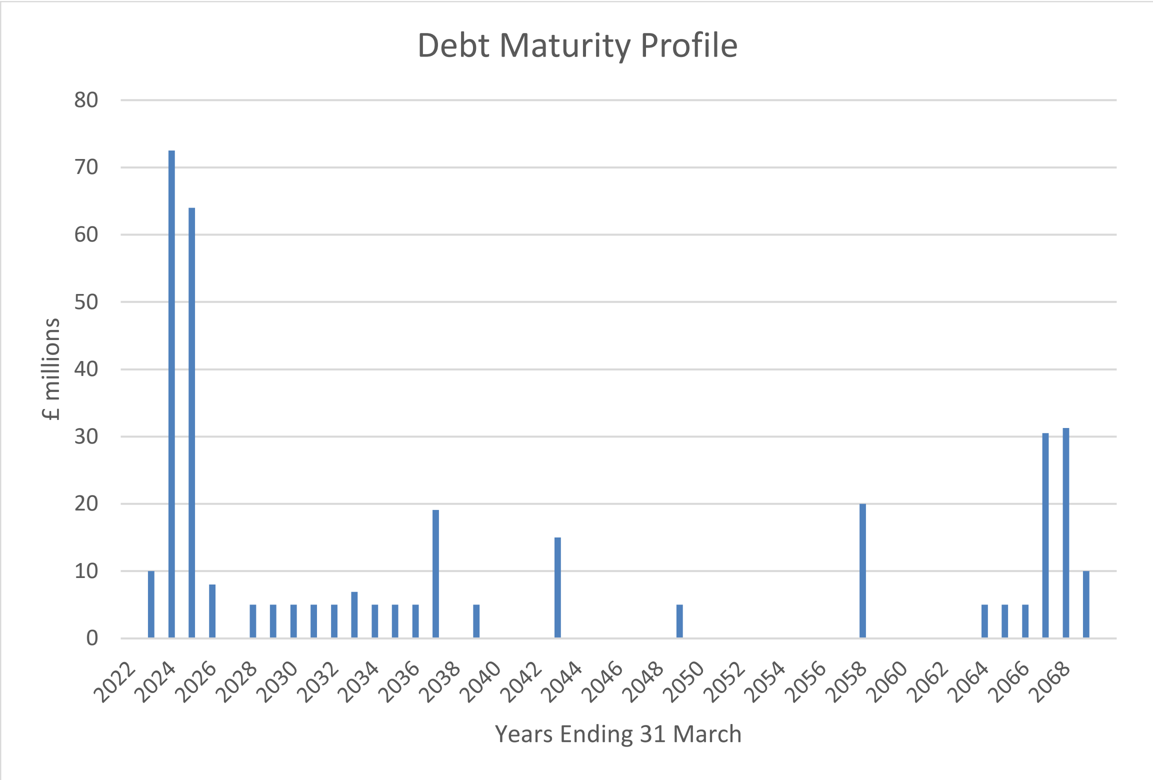
4.3.4 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Chief Operating 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 borrowing rates,* then borrowing would be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding would be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reports at the next available opportunity.

4.3.5 The repayment dated for maturity loans is shown below:



4.3.6 The long-term aim of officers is 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, as and a significant amount of capital receipts are expected in the next few years, a higher level of short to medium-term loans from other local authorities will be held in the immediate term.

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

4.4.1 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)

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

4.5 Treasury Indicators: limits to borrowing activities

4.6 The Operational Boundary

4.6.1 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	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
Debt	627,811	640,386	583,657	556,678
Other long-term liabilities	2,000	2,000	2,000	2,000
Total	629,811	642,386	585,671	558,678

4.7 The authorised limit for external debt.

4.7.1 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	2022/23 Estimate £000s	2023/24 Estimate £000s	2024/25 Estimate £000s	2025/26 Estimate £000s
Debt	690,592	704,424	642,038	612,346
Other long-term liabilities	2,200	2,200	2,200	2,200
Total	692,792	706,624	644,238	614,546

Upper Limit for Fixed Interest Rate Exposure	2022/23 £000s	2023/24 £000s	2024/25 £000s	2025/26 £000s
Net principal fixed rate borrowing	692,792	706,624	644,238	614,546
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	125,000	125,000	125,000	125,000

Upper Limit for Variable Rate Exposure	2022/23 £000s	2023/24 £000s	2024/25 £000s	2025/26 £000s
Net principal investment/borrowing (excluding LOBOs) at variable rate	150,000	150000	150,000	150,000
LOBO limit	102,000	102,000	102,000	102,000

Maturity Structure of Fixed rate Borrowing during 2023/24	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%

4.7.2 A limit of £100m has applied from 2020/21 for fixed rate loans to subsidiaries. This Strategy increases this limit to £125m to reflect increased requirements at Medway Development Company (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.

4.7.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 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 would be postponed, and potential rescheduling from fixed rate funding into short term borrowing would 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 would be re-appraised with the likely action that fixed rate funding would be drawn whilst interest rates are still lower than they will be in the next few years.

4.7.4 This Strategy reflects an increase in the monetary limit for borrowing at variable rates excluding LOBOs (which includes all loans maturing within 12 months) from £100m to £150m. Significant amounts of capital receipts are expected in the next few years which makes longer term borrowing less appropriate.

4.8 Policy on borrowing in advance of need

4.8.1 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.

4.8.2 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.

4.9 Prospects for Interest Rates

4.9.1 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 8 November 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

Additional notes by Link on this forecast table: -

- Our central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.
- Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.
- Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.
- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)
- On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

4.9.2 Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

4.9.3 Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside. Indeed, the Bank of England projected two years of negative growth in their November Quarterly Monetary Policy Report.

4.9.4 **Downside Risks to current forecasts for UK yields and PWLB rates include**:

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next two years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

4.9.5 Upside risks to current forecasts for UK gilt yields and PWLB rates include:

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than we currently expect.
- **The Government** acts too slowly to increase taxes and/or cut expenditure to balance the public finances, in the light of the cost-of-living squeeze.
- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term **US treasury yields** rise strongly, if inflation numbers disappoint on the upside

4.10 Investment and borrowing rates

4.10.1 Link's long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

4.10.2 Suggested earnings rates for investments up to about three months' duration in each financial year are as follows:

Average earnings in each year	
2022/23 (remainder)	3.95%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

4.10.3 As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

4.10.4 Link's interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, they continue to monitor events and will update our forecasts as and when appropriate.

4.10.5 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.

4.11 Debt Rescheduling

4.11.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as PWLB rates for premature repayments are unattractive.

4.11.2 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 Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in the Capital Strategy, (a separate report).

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

- DLUHS's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code")
- CIPFA Treasury Management Guidance Notes 2021

5.1.4 The Authority's investment priorities will be security first, portfolio liquidity second and then yield (return). The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the Authority's risk appetite.

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 in 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.) At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by Government.

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.

Upper limit for principal sums invested for longer than 365 days

	2022/23 £m	2023/24 £m	2024/25 £m
Principal sums invested for longer than 365 days	150	150	150
Current Investments as at 30.11.21 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 4.463% for 2022/23 remains higher than currently available long- term debt rates, the penalty involved in early repayment makes early redemption an unattractive option. The outstanding principal at 1 April 2023 will be £28.9 million.

7. Minimum Revenue Provision (MRP)

7.1 The Minimum Revenue Provision is explained and the Policy Statement for 2023/24 is set out at Appendix 1.

7.2 A review of MRP undertaken by our treasury advisors revealed an over-provision had been 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 2023/24

Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Authority has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP).

The Authority is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full council approval in advance of each financial year.

The Authority is recommended to approve the following MRP Statement:

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 DLUHC 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 2022-25

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

Appendix 3 – Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2022/23	2023/2024	2024/2025	2025/2026
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000
Capital Expenditure				
Non - HRA	161,806	109,123	163,380	11,539
HRA	13,207	12,285	2,177	0
TOTAL	175,013	121,408	165,557	11,539
Ratio of financing costs to net revenue stream				
Non - HRA	2.24%	3.86%	3.41%	2.99%
HRA	12.27%	12.99%	14.50%	13.91%
Gross borrowing requirement				
brought forward 1 April	335,429	450,788	463,363	406,648
carried forward 31 March	450,788	463,363	406,648	379,655
in year borrowing requirement	115,359	12,575	(56,715)	(26,993)
Capital Financing Requirement as at 31 March				
Non – HRA	483,434	491,383	432,897	406,328
HRA	44,377	49,003	50,774	50,350
TOTAL	527,811	540,386	483,671	456,678
Annual change in Cap. Financing Requirement				
Non- HRA	111,664	7,948	(58,485)	(26,569)
HRA	3,695	4,627	1,770	(424)
TOTAL	115,359	12,575	(56,715)	(26,993)

TREASURY MANAGEMENT INDICATORS	2022/2023	2023/2024	2024/2025	2025/2026
	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£’000	£'000
Authorised Limit for external debt -				
Borrowing	690,592	704,424	642,038	612,346
Other Long-term liabilities	2,200	2,200	2,200	2,200
TOTAL	692,792	706,624	644,238	614,546
Operational Boundary for external debt -				
Borrowing	627,811	640,386	583,671	556,678
Other long-term liabilities	2,000	2,000	2,000	2,000
TOTAL	629,811	642,386	585,671	558,678
Estimated actual external debt (31 March)	450,788	463,363	406,648	379,655
Upper limit for fixed interest rate exposure				
Net principal re fixed rate borrowing	450,788	463,363	406,648	379,655
Net principal fixed rate investment (exc. Subsidiaries)	50,000	50,000	50,000	50,000
Net principal fixed rate loans to subsidiaries of Medway Council	125,000	125,000	125,000	125,000
Upper limit for variable rate exposure				
Net principal re variable rate borrowing / investments (excluding LOBOs)	150,000	150,000	150,000	150,000
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 2023/2024	**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 and 3	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 4	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
- 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 2022

Job titles have been changed for various practices reflecting the reorganisation of Finance which took effect in 2022. In addition the following specific changes have been made:

Treasury Management Practice 1: Treasury Risk Management

- References 1.24 borrowing limits updated to reflect figures in this strategy
- 1.48 reference to a 3-year capital plan amended to 3+ years
- 1.77 faster payments added to the list of payment methods
- 1.79 a paper-based treasury diary is no longer maintained andy borrowing or lending transactions are now entered directly on the cashflow spreadsheet

Treasury Management Practice 5: Organisation, clarity and segregation of responsibilities and dealing

- 5.1 the frequency of treasury reporting increased to quarterly
- 5.5 staff structures updated

Treasury Management Practice 6 Annual Treasury Management Strategy Statement

- 6.5 liability benchmark added to the list of elements of the TMSS

Treasury Management Practice 7: Budgeting, accounting and audit arrangements

- medium term financial plan no longer restricted to 3 years

Treasury Management Practice 10: Training and qualifications

- 10.9 list of staff and qualifications updated

Treasury Management Practice 12: Corporate Governance

- 12.4 document list amended to include quarterly reports