Medway Council
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Audit Committee

30 July 2026

Treasury Management Report 2026/27: Quarter 1

Report from: Abbey Gough, Chief Finance Officer

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Summary:

This report gives an overview of treasury management activity for 2026/27 quarter 1. The report will also be considered by Cabinet on 22 August 2026.

1. Recommendation

1.1. The Committee is asked to note the treasury management report 2026/27 quarter 1.

2. Budget and Policy Framework

2.1. The Council's Treasury Management Strategy and Policy are approved by Full Council following consideration by Cabinet and Audit Committee. The Audit Committee is responsible for approving the quarterly treasury reports.

3. Background

3.1. In April 2002 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

3.2. This quarterly report provides an additional update and includes the requirement in the 2021 Code of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Authority's normal quarterly [revenue and capital monitoring] report.

3.3. The Authority's treasury management strategy for 2026/27 was approved at Full Council on 25 February 2026. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

4. External Context

4.1. Economic background

4.1.1. The main story for the quarter was the continuation of the Middle East conflict, started on 28 February with strikes by Israel and the US on Iran. The conflict led to the closure of the Hormuz Strait, a waterway through which around 20% of the world's oil and liquified natural gas flows, resulting in sharp rises in energy and other commodity prices. Towards the end of the quarter, the US and Iran came to an agreement to negotiate a peace settlement, which prompted a reduction in energy commodity prices, albeit remaining higher than pre-war.

4.1.2. Coming close on the heels of the last energy price shock in 2022 following Russia's invasion of Ukraine, central bank policymakers and financial markets reacted quickly to reflect the new reality for monetary policy. In the UK, the headline consumer price inflation (CPI) rate was widely expected to fall back to 2% in April, with changes to government energy policy announced in the budget reducing energy bills and therefore headline inflation rates. Instead, the sharp rise in petrol prices occurring from the war maintained the CPI rate well above target at 2.8%.

4.1.3. Having been expected to cut Bank Rate from 3.75%, the Bank of England's Monetary Policy Committee (MPC) instead held Bank Rate steady throughout the quarter. Despite sending hawkish signals with each monetary policy decision, and the voting split changing from a 9-0 hold in March to a 7-2 hold in June, the majority of committee members appear to believe the UK economy and labour market were soft enough to absorb the price shock without producing the persistent inflationary conditions seen in 2022, which led to Bank Rate rising to 5.25%. This appears to be backed up by business surveys towards the end of the quarter suggesting that business pricing pressures, while elevated, are abating.

4.1.4. Against expectations, UK headline CPI decreased over the quarter, from an annual rate of 3.3% in March to 2.8% in May, but still well above the Bank of England's 2% target. The core measure of CPI inflation also decreased, from 3.1% to 2.6% over the same period. Upside pressure in inflation generally reflected fuel prices, but many other categories experienced disinflation, providing some evidence that higher energy prices were not immediately feeding into a wider subset of products.

4.1.5. Inflation will rise from July, however, as the retail energy price cap is increased by 13%. Expectations range from inflation rising to 3.5% to 4.0% and the MPC's resolve to maintain Bank Rate at 3.75% will likely be tested as this point.

4.1.6. Data released during the period showed the UK economy expanded by 0.6% in the first quarter of the calendar year, following three previous quarters of weaker growth. However, monthly GDP data showed a contraction of 0.1% in April as weaker confidence affected spending and investment decisions. Purchasing managers' index (PMI) data indicated that softer growth was also likely in May and June, with the services PMI denoting a small contraction in activity from both months.

4.1.7. Labour market data showed a continued softening in employment conditions, as weaker private sector earnings growth was reported for the period February to April 2026. The unemployment rate for April was 4.9%, PAYE employment was down over the year, and the number of vacancies continued to fall. The looser labour market is supporting the MPC's decision not to tighten monetary policy, with the likelihood of wage growth rising in line with inflation appearing remote.

4.1.8. Arlingclose, the authority's treasury adviser, maintained its central view that Bank Rate remain at 3.75%, and that the Bank of England would focus on the spare capacity in the economy, notably the labour market, rather than the upside risk of persistent inflation. The balance of risks over the near term, however, is deemed to be to the upside as signs of second round inflationary effects will prompt policymakers to raise interest rates. Over the medium term, the balance of risk for Bank Rate shifts to the downside, with tighter monetary policy, higher prices and weaker growth presenting downside risks for inflation.

4.1.9. The US Federal Reserve also held interest rates steady the period, maintaining the Fed Funds Rate at 3.50%-3.75%. The decision in June was the sixth consecutive month where no changes were made to the main interest rate. US CPI jumped to 4.2% in May on the back of higher gasoline prices, raising the possibility that policy under new Fed Chair Kevin Warsh may lead to higher rather than lower rates.

4.1.10. The European Central Bank (ECB) hiked rates in June, the first rise since September 2023. The ECB noted heightened uncertainty in the near-term from the effects of the war, including higher inflation and potentially weaker growth. The June hike to 2.40% represented an insurance move to maintain inflation around the 2% target.

4.1.11. Financial markets: After the sharp deterioration early in the quarter, sentiment in financial markets showed signs of improvement during the period as hopes for an end to the US/Israel war with Iran increased. However, bond and equity markets remained volatile. Early in the period bond yields rose sharply due to tighter monetary policy expectations but yields steadily declined as it became apparent central banks, including the Bank of England, were not going to immediately hike policy rates. Equity markets sold off sharply in March but gained back some of the previous declines, particularly in US markets, where AI-related sentiment remained strong.

4.1.12. Political uncertainty in the UK due to poor local election results for the Labour party placed upward pressure on medium and longer-term gilt yields. The resignation of Keir Starmer and the succession of Andy Burnham reduced some uncertainty and prompted a decline in yields.

4.1.13. Over the quarter, the 10-year UK benchmark gilt yield started at 4.86% and ended at 4.77% having hit 5.20% in late April. The 20-year gilt yield was slightly more stable, starting at 5.45% and finished at 5.42%, after peaking at 5.79% in May. The Sterling Overnight Rate (SONIA) averaged 3.73% over the quarter to 30th June.

4.2. Credit review

4.2.1. Arlingclose maintained its advised recommended maximum unsecured duration limit on the majority of the banks on its counterparty list at 6 months. Other banks remain on 100 days.

4.2.2. During the quarter, Fitch upgraded numerous banks due to a rating methodology change, which placed greater emphasis on resolution regimes, loss-absorbing debt buffers and depositor protection. It also changed the reference obligations used for Issuer Default Ratings and introduced more differentiated notching between deposits, senior preferred, senior unsecured and senior non-preferred debt ratings.

4.2.3. Moody's also made changes to the ratings of European banks following the passing of EU legislation introducing full depositor preference across the bloc which places deposits ahead of senior unsecured debt in the creditor hierarchy. This resulted in upgrades to the ratings to several counterparties on Arlingclose's recommended list.

4.2.4. Credit default swap (CDS) prices on UK banks spiked through late March/early April following escalation in the Iran war but eased back over the rest of the quarter to end at broadly pre-conflict levels.

4.2.5. European banks' CDS prices followed a similar pattern, albeit some German banks were modestly higher compared to the previous quarter. Trade tensions between Canada and the US caused Canadian bank CDS prices to rise over the quarter and remain elevated compared to earlier Q1 2026 while Australian and Singaporean lenders were broadly unchanged.

4.2.6. Overall, at the end of the period CDS prices for all banks on Arlingclose's counterparty list remained within limits deemed satisfactory for maintaining credit advice at current durations.

4.2.7. Financial market volatility is expected to remain a feature, at least in the near term, and credit default swap levels will be monitored for signs of ongoing credit stress. As ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remain under constant review.

5. Local Context

5.1. On 31 March 2026, the Authority had net borrowing of £544million arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.03.25 Actual £'000	31.03.26 Actual £'000	2026/27 Per Strategy £'000	2026/27 Round 1 Forecast £'000
General Fund CFR	543,647	630,018	764,630	701,580
HRA CFR	42,386	47,169	68,833	64,552
Total CFR	**586,034**	**677,187**	**833,463**	**766,132**
Less: *Other debt liabilities	(26,635)	(25,570)	0	(24,547)
Borrowing CFR	**559,399**	**651,617**	**833,463**	**741,585**
External borrowing**	(585,706)	(713,535)	(830,870)	(809,850)
Internal (over) borrowing	**(26,307)**	**(61,918)**	**2,593**	**(68,265)**
Less: Balance sheet resources				
Investments	**147,514**	**169,593**	**180,973**	**210,973**

* transferred debt that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing

5.2. The treasury management position at 30 June and the change over the quarter is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.26 Balance £'000	Movement £'000	30.6.26 Balance £'000	30.6.26 Rate %
Long-term borrowing				
- PWLB	441,025	(45,001)	396,024	4.38
- LOBOs	50,500	0	50,500	4.33
- Other	37,510	(12,010)	25,500	4.64
Short-term borrowing	184,500	31,010	215,510	4.33
Total borrowing	**713,535**	**(26,001)**	**687,534**	**4.37**
Long-term investments	(17,394)	3,115	(14,279)	4.83
Short-term investments	(11,699)	(7,382)	(19,082)	3.80
Cash and cash equivalents	(84)	(2,951)	(3,035)	3.51
Total investments	**(29,177)**	**(7,218)**	**(36,395)**	**4.18**
Net	**684,358**	**(33,219)**	**651,139**	

5.3. The need to borrow has reduced by £26m during the first quarter whereby cash reserves enable borrowing redeemed to not have to be replaced by further borrowing, a stance that will continue wherever possible.

5.4. The reduction in property fund values are due to a small reduction in values (£89,000) together with a partial redemption of just over £2,9m from the former Patrizia Hanover fund which ceased trading on 30 June 2026 and has been taken over by TPUT Handel Property Unit Trust. This redemption equated to 190 out of the 354 units held, leaving a further 164 units to be redeemed as and when the fund can realise capital.

5.5. Short term investments relate to the CCLA public sector deposit fund whilst the cash and cash equivalents are call accounts from banks such as Lloyds and Nat West. These two types of investments are used to hold cash and gain interest when cash flow allows.

5.6. Borrowing Strategy and Activity

5.6.1. As outlined in the treasury strategy, the Authority's chief objective when borrowing has been to strike an appropriate risk balance between securing lower interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective. The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

5.6.2. Gilt yields have moved about during the period but overall have decreased slightly. Oil prices have reduced and inflationary figures in the UK have not risen by as much as markets initially expected. Concerns about the tepid UK economy have also lessened expectations of future rate rises which has lowered gilt yields.

5.6.3. The PWLB certainty rate for 5-year maturity loans was 5.16% at the beginning of the period and 5.07% at the end. The lowest available 5-year maturity certainty rate was 5.04% and the highest was 5.49%. In contrast rates for 20-year maturity loans ranged from 6.02% to 6.50% during the period, and 50-year maturity loans from 5.89% to 6.35%. After coming down from a characteristic spike seen around financial year end, the cost of short term borrowing from other local authorities has remained a little above Base Rate, at between 4.0% and 4.5%, throughout the period.

5.6.4. CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes. The Authority has no new plans to borrow to invest primarily for financial return.

5.6.5. The PWLB HRA rate which is 0.4% below the certainty rate is available up to March 2027. This discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans, (add, if applicable) providing a window of opportunity for HRA-related borrowing and to replace the Authority's £47m loans relating to the HRA maturing during this time frame.

5.6.6. Loans Portfolio: At 30 June 2026 the Authority held £688million of loans, a decrease of £26million compared to 31st March 2026, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30 June 2026 are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.03.26	**Net Movement**	**30.06.26**	**30.06.26**	**30.06.26**
	Balance	**£'000**	**Balance**	**Weighted Average**	**Weighted Average**
	£'000		**£'000**	**Rate**	**Maturity**
				%	**(years)**
Public Works Loan Board	546,025	(25,001)	521,024	4.16	4.27
Banks (LOBO)	50,500	0	50,500	4.17	30.66
Local authorities (long-term)	37,510	(12,010)	25,500	4.59	2.32
Local authorities (short-term)	79,500	11,010	90,510	4.86	0.39
Total borrowing	**713,535**	**(26,001)**	**687,534**	**4.27**	**5.63**

5.6.7. The Authority's short-term borrowing cost has reduced over the past 3 months. The average rate on the Authority's short-term loans at 30 June 2026 on £215.5million was 4.33%, this compares with 4.85% on £184.5million 3 months ago.

5.6.8. The Authority's borrowing decisions have been manly been predicated the need to borrow short term due to the volitivity in the markets and heightened interest rates in the recent past. Whilst rates had started to ease, the recent increase in tensions in the Middle East have seen rates start to increase once again. Whilst a balanced portfolio of short and long-term borrowing would be the ideal, officers are currently reviewing options with the assistance of our treasury advisors, Arlingclose.

5.6.9. There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

5.6.10. LOBO (Lender's Option Borrower's Option) loans: On 1st April 2026 the Authority held £50.5million of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate and terms or to repay the loan at no additional cost.

5.6.11. As market interest rates have risen, there has been an increased probability of call options on the LOBOs being exercised by lenders. No LOBO loans were called during the first quarter of 2026/27.

5.6.12. The Authority has £40million LOBO loans with call dates within the next 12 months. If the option is exercised and an increased rate proposed, the Authority plans to repay the loan at no additional cost as accepting the revised terms would mean the Authority would still have refinancing risk in later years. If required, the Authority will repay the LOBO loans with available cash or by borrowing from other local authorities or the PWLB.

5.7. Treasury Investment Activity

5.7.1. The CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (revised in 2021) defines treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

5.7.2. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.7.3. Externally Managed Pooled Funds: £14.3million of the Authority's investments is invested in externally managed strategic pooled property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

5.7.4. UK commercial property capital returns were broadly flat to modestly negative over the quarter, with performance continuing to be driven primarily by income rather than capital growth. Although the commercial property market has stabilised compared with the more difficult conditions seen in recent years, economic uncertainty, elevated financing costs and movements in gilt yields continued to weigh on investor sentiment. Rental income therefore remained the main contributor to total return, while capital values remained subdued.

5.7.5. The combination of the above had a negative effect on the combined value of the Authority's funds since March 2026.

5.7.6. The Authority has budgeted £526,000 income from these investments in 2026/27. Income received up to 30 June was just over £50,000, whilst the dividend from one property fund for quarter one is still to be made. Over the quarter, these funds generated an overall £90,000 of unrealised capital loss.

5.7.7. Because the remaining fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Authority's medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three to five-year period total returns will exceed cash interest rates.

5.7.8. Statutory override: Further to consultations in April 2023 and December 2024 the Ministry for Housing Communities and Local Government (MHCLG) wrote to finance directors in England in February 2025 regarding the statutory override on accounting for gains and losses in pooled investment funds. The statutory override has been extended up until the 1 April 2029 for investments already in place before 1st April 2024. The override does not apply to any new investments taken out on or after 1 April 2024.

5.8. Non-Treasury Investments

5.8.1. The definition of investments in the Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

5.8.2. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also includes within the definition of investments all such assets held partially or wholly for financial return.

5.8.3. The Authority also held £152million of such investments in loans to subsidiaries.

5.8.4. These investments are projected to generate just under £10.8million of investment income for the Authority after taking account of direct costs, representing a rate of return of 5.96% for 2026/27.

5.8.5. Investments Portfolio: At 30 June 2026 the Authority held £196.329million of investments, both treasury and non-treasury, an increase of £10.17million compared to 31 March 2026.

Table 3B: Treasury and Non-Treasury Investments Position:

	31.3.26	**Movement**	**30.6.26**	**30.6.26**
	Balance		**Balance**	**Rate**
	£'000	**£'000**	**£'000**	**%**
Long-term investments	(17,394)	3,115	(14,279)	4.83
Short-term investments	(11,699)	(7,382)	(19,082)	3.80
Cash and cash equivalents	(84)	(2,951)	(3,035)	3.51
Non-Treasury Investments	(152,433)	(2,951)	(159,933)	5.64
Total investments	**(181,610)**	**(10,170)**	**(196,329)**	**5.37**

5.9. Treasury Performance

5.9.1. The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below.

5.9.2. A breakdown of the Interest and Financing budget is shown below:

Table 4 :Interest and Finance Budget against spend:

	Budget 2026/27	**Round 1 Forecast**	**(Under)/ Overspend**
	£000	**£000**	**£000**
Interest Earned	(13,351)	(13,787)	(437)
Interest Paid	28,497	33,387	4,890
KCC Principal	1,023	1,023	0
MRP	8,365	8,125	(240)
Treasury Costs	176	124	(52)
Total	**24,710**	**28,872**	**4,162**

5.10. Compliance

5.10.1. The Chief Operating Officer reports that all treasury management activities undertaken during the quarter complied fully with the principles in the Treasury Management Code and the Authority's approved Treasury Management Strategy.

5.10.2. Compliance with the Authorised Limit and Operational Boundary for external debt is demonstrated in table 5 below.

Table 5: Debt and the Authorised Limit and Operational Boundary

	Q1 2026/27 Maximum	**30.6.26 Actual £,000**	**2026/27 Operational Boundary £'000**	**2026/27 Authorised Limit £'000**	**Complied?** Yes/No
Borrowing	713,535	687,534	825,777	908,355	Yes
Total debt	**713,535**	**687,534**	**825,777**	**908,355**	

5.10.3. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

6. Risk Management

6.1. Risk and the management thereof is a key feature throughout the strategy and in detail within the treasury management practices (TMP1) within the Treasury Strategy.

7. Financial Implications

7.1. Overall, the Interest and Financing costs at round 1 were forecast to overspend by just under £4.2million against the 2026/27 approved budget.

7.2. The body of the report outlines the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the Council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

8. Legal implications

8.1. Our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

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Appendices
None

Background papers
None