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TONBRIDGE & MALLING BOROUGH COUNCIL

EXECUTIVE SERVICES

Chief Executive
Julie Beilby BSc (Hons) MBA

Gibson Building
Gibson Drive
Kings Hill, West Malling
Kent ME19 4LZ
West Malling (01732) 844522

Contact: Committee Services
committee.services@tmbc.gov.uk

27 July 2018

COUNCIL - TUESDAY, 31ST JULY, 2018

I am now able to enclose, for consideration at the Tuesday, 31st July, 2018 meeting of the Council, the following reports that were unavailable when the agenda was printed.

Agenda No Item

18. **Treasury Management Update and Annual Report for 2017/18 (Pages 3 - 28)**

Item AU 18/30 referred from Audit Committee minutes of 23 July 2018

J E BEILBY
Chief Executive

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Item AU 18/30 referred from Audit Committee minutes of 23 July 2018

AU 18/30 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2017/18

The report of the Director of Finance and Transformation provided an update on treasury management activity undertaken during April to June of the current financial year within the context of the national economy. The treasury management outturn position for 2017/18 was also presented.

The report provided a commentary on investments derived from cash flow surpluses, core cash balances and other long term cash balances and it was noted that long term investment at the end of June 2018 comprised £4m in property fund investment. A further £1m was placed in a property fund on 2 July 2018 bringing the Council's total property fund investment to £5m. A full list of investments held on 30 June 2018 was set out at Annex 2 to the report.

RECOMMENDED: That the following be commended to the Council:

(1) the action taken by officers in respect of treasury management activity for April to June 2018 be endorsed;

(2) the £5m in property fund investments undertaken since June 2017 be noted; and

(3) the 2017/18 outturn position be noted.
***Referred to Council**

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TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

23 July 2018

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2017/18

The report provides an update on treasury management activity undertaken during April to June of the current financial year. The treasury management outturn position for 2017/18 is also included in this report.

1.1 Introduction

1.1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a revised Code of Practice for Treasury Management in November 2009. The revised Code was adopted by the Council on 18 February 2010 and suggests that Members should be informed of treasury management activity at least twice a year, but preferably quarterly. This report, therefore, ensures this Council is embracing best practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 The UK economy grew by 1.8% in 2017, its slowest rate of annual growth since 2012. Growth in the first quarter (Q1) of 2018 at 0.2% also disappointed. This was driven in part by the unusually bad weather that affected all parts of the country. The weak growth has also been attributed to the fall in consumer disposable income as inflation has, until recently, outstripped wage growth. Early data and surveys released in July suggest stronger growth in Q2 2018 improving again in Q3 2018.

1.2.2 In contrast to GDP, the labour market has continued to show strength with the unemployment rate maintaining its downward trend falling to a multi-decade low in April of 4.2%. At the same time pay growth, excluding bonuses, rose by 2.8% in April with survey data suggesting that upward trend will continue through 2018. CPI inflation whilst still above target (2.0%) has fallen from a high of 3.1% in November 2017 to 2.4% in May 2018. Inflation is expected to come under pressure from rising oil / energy prices in the short term but fall back later in the year from easing food prices and other imported goods inflation as the impact of the post referendum fall in the value of sterling fades.

1.2.3 At their February meeting, the Monetary Policy Committee voted unanimously to leave Bank Rate unchanged at 0.5%. However, the committee indicated 'rates would be increasing sooner and at a greater rate than was previously thought'. This prompted market expectation rising to near 100% of a Bank Rate increase in May. The May meeting disappointed and the Bank's stance changed to a data dependent wait and see. The improving economic position and the split vote (6:3) at the June meeting has again led to growing market expectation of an early rate rise (70% expectation that this will take place in August).

1.3 Interest Rate Forecast

1.3.1 The Bank Rate having remained at a historic low of 0.5% for over seven years was cut to 0.25% in August 2016. In November 2017, the Bank of England returned the Bank Rate to 0.5%. Link's current forecast (May 2018) anticipates the Bank Rate rising to 0.75% by December 2018 and to 1.0% by September 2019.

Rate	Now	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
	%	%	%	%	%	%	%	%	%	%	%	%
Bank Rate	**0.50**	**0.50**	**0.75**	**0.75**	**0.75**	**1.00**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**
3 mth LIBID	**0.60**	**0.70**	**0.90**	**0.90**	**0.90**	**1.10**	**1.20**	**1.30**	**1.40**	**1.50**	**1.60**	**1.60**
6 mth LIBID	**0.70**	**0.80**	**1.00**	**1.00**	**1.00**	**1.20**	**1.20**	**1.30**	**1.50**	**1.60**	**1.70**	**1.70**
12 mthLIBID	**0.80**	**0.90**	**1.10**	**1.10**	**1.20**	**1.30**	**1.40**	**1.40**	**1.60**	**1.70**	**1.80**	**1.80**
25yr PWLB	**2.70**	**2.80**	**2.90**	**3.00**	**3.10**	**3.20**	**3.30**	**3.30**	**3.40**	**3.40**	**3.50**	**3.50**

1.4 Investment Performance

1.4.1 In accordance with the CIPFA Code the Council's priorities, in order of importance, are: to ensure security of capital; liquidity; and having satisfied both, to obtain an appropriate level of return which is consistent with the Council's risk appetite.

1.4.2 The Council's investments are derived from cash flow surpluses, core cash balances and other long term cash balances.

1.4.3 Cash flow surpluses are available on a temporary basis and the amount mainly dependent on the timing of council tax and business rates collected and their payment to precept authorities and government. Less significant cash flows relate to receipt of grants, payments to housing benefit recipients, suppliers and staff. Cash flow surpluses build up during the course of a financial year and are spent by financial year end **[Annex 1]**. Thus far in 2018/19 cash flow surpluses have averaged £8.8m.

1.4.4 The Authority also has £22m of core cash balances. These funds are for the most part available to invest for more than one year, albeit a proportion is usually transferred to cash flow towards the end of the financial year to top-up daily cash balances. Core cash includes the Council's capital and revenue reserves which are being consumed over time to meet capital expenditure and 'buy time' to enable the authority to deliver its revenue savings targets. The core cash balance also includes some £4m to meet business rate appeals which are expected to be resolved in 2018/19.

1.4.5 Long term investment at the end of June 2018 comprised £4m in property fund investments. A further £1m was invested in a property fund on 2 July 2018.

1.4.6 A full list of investments held on 30 June 2018 is provided at **[Annex 2]** and a copy of our lending list of 2 July 2018 is provided at **[Annex 3]**. The table below provides a summary of funds invested and interest / dividends earned at the end of June.

	Funds invested on 30 June 2018 £m	**Average duration to maturity Days**	**Weighted average rate of return %**	**Interest / dividends earned 1 April to 30 June 2018 £**	**Gross annualised return %**	**LIBID benchmark (average from 1 April 2018) %**
Cash flow	9.1	2	0.52	10,950	0.50	0.36 (7 Day)
Core cash	22.0	178	0.86	44,600	0.78	0.56 (3 Mth)
Sub-total	**31.1**	**126**	**0.76**	**55,550**	**0.70**	**0.50 (Ave)**
Long term	4.0			30,900	3.74	
Total	35.1					

Dividends / return on long term investments is based on dividends declared by the Local Authorities' Property Fund and the Lothbury Property Trust and an estimated dividend for the Hermes Property Unit Trust (HPUT). HPUT's dividend for April to June will be declared mid-August.

1.4.7 **Cash flow and Core cash Investments**. Interest earned of £55,500 to the end of June is £10,300 better than the original estimate for the same period. The authority also outperformed the LIBID benchmark by 20 basis points. The additional income is due in part to the higher core fund balances (unspent business rate appeals provisions) and in part due to an improvement in investment rates banks were offering in March and April in anticipation of a May rise in Bank Rate. Investment rates have since fallen back to post November 2017 Bank Rate rise levels.

1.4.8 The Council takes advantage of Link's benchmarking service which enables performance to be gauged against Link's other local authority clients. An extract from the latest benchmarking data is provided in the form of a scatter graph at **[Annex 4]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. As at 31 March 2018 our return at 0.67% (purple diamond) was above the local authority average of 0.61%. Based on the Council's exposure to credit / duration risk that return was also above Link's predicted return (above the upper boundary indicated by the green diagonal line). The Council's risk exposure was broadly in-line with the local authority average.

1.4.9 **Long term investment**. The availability of cash balances over the longer term (10 years) and the suitability of different types of long term investment (equities, bonds and property) was explored in the report to Audit Committee, January 2017. Of the alternatives, investment in property funds was considered best suited to meet the Council's more immediate funding need (a sustainable, stable income stream). The use of property funds for both existing cash balances and any new money derived from the sale of assets was subsequently approved by Council in February 2017 and reaffirmed in February 2018.

1.4.10 Link Asset Services were engaged to assist with the detailed analysis required to identify the most appropriate fund(s). The analysis produced a shortlist of four funds who were invited to attend an interview at the Council's offices in late May 2017. The process culminated in three funds being selected for immediate investment.

1.4.11 Of the Council's existing cash balances, £2m was identified for long term investment and has been applied to investment in property funds. A further £1m anticipated from the disposal of existing property assets was applied in 2017/18 bringing the total investment in property funds in last financial year to £3m. Investment was spread across three funds to ensure, as far as is possible, stability of annual income and capital growth over time.

1.4.12 Funds issue / redeem primary units at a buy / sell price with the difference between the two prices reflecting the costs associated with buying and selling a property (legal and other fees, stamp duty etc.). The price spread varies from fund to fund but is typically in the region of 8% (6% on entry to a fund and 2% on exit). Where units are traded on a secondary market the impact of the spread can be reduced and delays in the purchase or redemption of units avoided. However, secondary market activity is limited.

1.4.13 £1m in primary units in the Local Authorities' Property Fund (LAPF) and Lothbury Property Trust (LPT) were acquired at the end of June 2017 from the fund managers at the standard entry price. The sale value of the units acquired is currently valued below the £1m cash sum paid to each manager by £36,500 (3.7%) for LAPF and £7,850 (0.8%) for LPT. Units in the Hermes Property Unit Trust (HPUT) were acquired at the end of September 2017 through an auction of secondary units arranged by the fund manager. The Council's participation in the auction delivered a saving of £7,000 against the standard entry price. At the end of June 2018 the sale value of HPUT units is £9,900 (1.0%) below the £1m cash sum paid.

1.4.14 The sale value of units in each fund has increased at a steady rate each month since they were acquired. Provided the economy / demand for commercial property continues the sale value of units in each fund will exceed the cash sum paid sometime during this financial year (some 12 to 18 months from the start of each investment).

1.4.15 More recently, a further £1m in primary units were acquired in the Local Authorities' Property Fund at the end of May 2018. At the end of June these units have a sale value below purchase price of £76,200 (7.6%). At the beginning of July a further £1m in units were also purchased in the Lothbury Property Trust. These units were acquired via the secondary market and generated a net saving against the standard entry price of £44,200 after deducting broker fees. The Lothbury units have a value if sold back to the fund manager of £27,000 (2.7%) below the £1m cash sum paid. These additional purchases are expected to be funded from the 2018/19 business rates pilot grant (£0.5m), the better than expected 2017/18 outturn (£0.5m) and (£1m) from sale proceeds associated with the River Walk Offices and Teen & Twenty site. Further investment in the Hermes Property Unit Trust is also envisaged later this financial year though purchase of units is dependent on progress being made with the property disposals mentioned above.

1.4.16 Thus far the property funds have recorded a return of 3.74% broadly in-line with our forecast return of 4%. Dividends to the end of June of £30,900 are £900 above profiled budget for the year. Performance against budget for the year as a whole will be influenced by the amount and timing of additional property fund investments.

1.5 Compliance with the Annual Investment Strategy

1.5.1 Throughout April to June 2018 all of the requirements contained in the 2018/19 Annual Investment Strategy intended to limit the Council's exposure to investment risks (minimum sovereign and counterparty credit rating; durational limits; exposure limits in respect of counterparties, groups of related counterparty and sovereigns; and specified and non-specified investment limits) have been complied with. No borrowing was undertaken during April, May or June 2018.

1.5.2 The Council has also operated within the treasury limits and prudential indicators set out in the Annual Investment Strategy. The Prudential and Treasury Indicators will be included for review as part of the treasury management report to the October 2018 meeting of Audit Committee.

1.6 Bank Ring-fencing

1.6.1 Ring-fencing is one of a number of reforms to the banking sector introduced following the 2008 financial crisis. It affects the largest UK banks (banks with more than £25 billion in consumer and small business deposits) and requires them to create separate legal entities - a ring-fenced bank for their retail operations and a non-ring fenced bank for their investment banking activities.

Smaller banks and building societies are exempt. Ring fenced banks will be restricted in the investment services and products they can provide to their customers and in their credit exposure (lending) to other financial institutions and certain corporate customers. The ring-fencing requirement takes effect on 1st January 2019.

1.6.2 Banks which are expected to be impacted by the ring-fencing requirement include HSBC, Barclays, Lloyds (including Bank of Scotland), RBS (including National Westminster) and Santander and therefore applies to the majority of UK institutions on the Council's approved lending list. All banks affected are currently progressing the legal steps necessary to create the new entities. As the entities are created and named / renamed the credit rating agencies are ascribing credit ratings to them. Unless UK nationalised, the Council's lending list only comprises banks which have as a minimum: a high long term credit rating (i.e. Fitch A-) and; a very high short term credit rating (i.e. Fitch F1). New / renamed entities that fail to satisfy these criteria are automatically excluded from our lending list and are not eligible for investment.

1.6.3 An additional column has been added to the Council's lending list so that the status of a UK bank as "Ring-fenced", "Non-ring fenced (Non-RF)" or Exempt is recorded and can inform the investment decision making process. At the end of June 2018, no investments were held with entities that fail to meet the Council's minimum credit requirement, or through likely to fail to do so, as a consequence of the ring-fencing measures.

1.7 2017/18 Treasury Management Outturn

1.7.1 A detailed report covering treasury management activity for the last financial year was submitted to Cabinet on 6 June 2018 as an annex to the Revenue and Capital Outturn report for 2017/18. That annex is replicated in full and provided at **[Annex 5]** to this report. The role of this Committee is to act as scrutineer on behalf of full Council.

1.7.2 A summary of the investment performance included in Annex 5 is as follows:

2017/18 Financial Year	2017/18 Average Balance £m	Return %	2017/18 Interest / Dividends £	2017/18 Revised Estimate £	Variance Better (Worse) £
Cash flow surpluses	14.8	0.47	69,357	52,000	17,357
Core cash	21.9	0.67	147,722	144,000	3,722
Long term investment	2.0	3.73	74,643	80,000	(5,357)
		Total	291,722	276,000	15,722

1.7.3 The combined performance of the Authority's investments bettered the revised estimate by £15,722 (£165,722 when compared to the 2017/18 original estimates).

1.8 Legal Implications

1.8.1 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority including securing effective arrangements for treasury management. In addition, Link are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.9 Financial and Value for Money Considerations

1.9.1 Investment income at the end of June 2018 (month three of the financial year) from cash flow surpluses and core cash investments is £10,300 better than budget for the same period. Income from property funds at the end of June is broadly in-line with budget expectations. Investment income for the 2017/18 financial year as a whole exceeded the revised budget by £15,722.

1.9.2 The Bank Rate having remained at a historic low of 0.5% for over seven years was cut to 0.25% in August 2016. In November 2017, the Bank of England returned the Bank Rate to 0.5%. Link's May 2018 forecast anticipates Bank Rate rising to 0.75% by December 2018.

1.9.3 Performance is monitored against a benchmark return and against other local authorities in Kent and the broader local authority pool via Link's benchmarking service.

1.9.4 Whilst the annual income stream from a property fund exhibits stability (circa 4% per annum net of management fees) capital values rise and fall with the cyclical nature of economic activity. During a downturn in the economy capital values may fall significantly. The duration of a property fund investment may need to be extended to avoid crystalizing a loss and as a consequence, the investment's duration cannot be determined with certainty.

1.9.5 Buying and selling property involves significant costs making property unsuitable for short term investment. Buying and selling costs are reflected in the entry fees (circa 6%) and exit fees (circa 2%) a property fund will charge unit holders. These fees are expected to be recouped overtime through capital appreciation.

1.9.6 The money being applied to property fund investment from existing resources is expected to be available in perpetuity. Nevertheless, the Council's cash balances will continue to be monitored and due regard had to the potential for a fund to delay payment of redemption requests by up to 12 months. Funds will seek to minimise their own cash balances in favour of holding property and therefore manage redemption requests for the benefit of all fund participants. The Council is only likely to seek redemption to pursue a higher yielding income opportunity should one be identified.

1.10 Risk Assessment

1.10.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered to be an effective way of mitigating the risks associated with treasury management.

1.11 Equality Impact Assessment

1.11.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act.

1.12 Recommendations

1.12.1 Members are invited to **RECOMMEND** that Council:

1) Endorse the action taken by officers in respect of treasury management activity for April to June 2018.

2) Note the £5m in property fund investments that have been undertaken since June 2017.

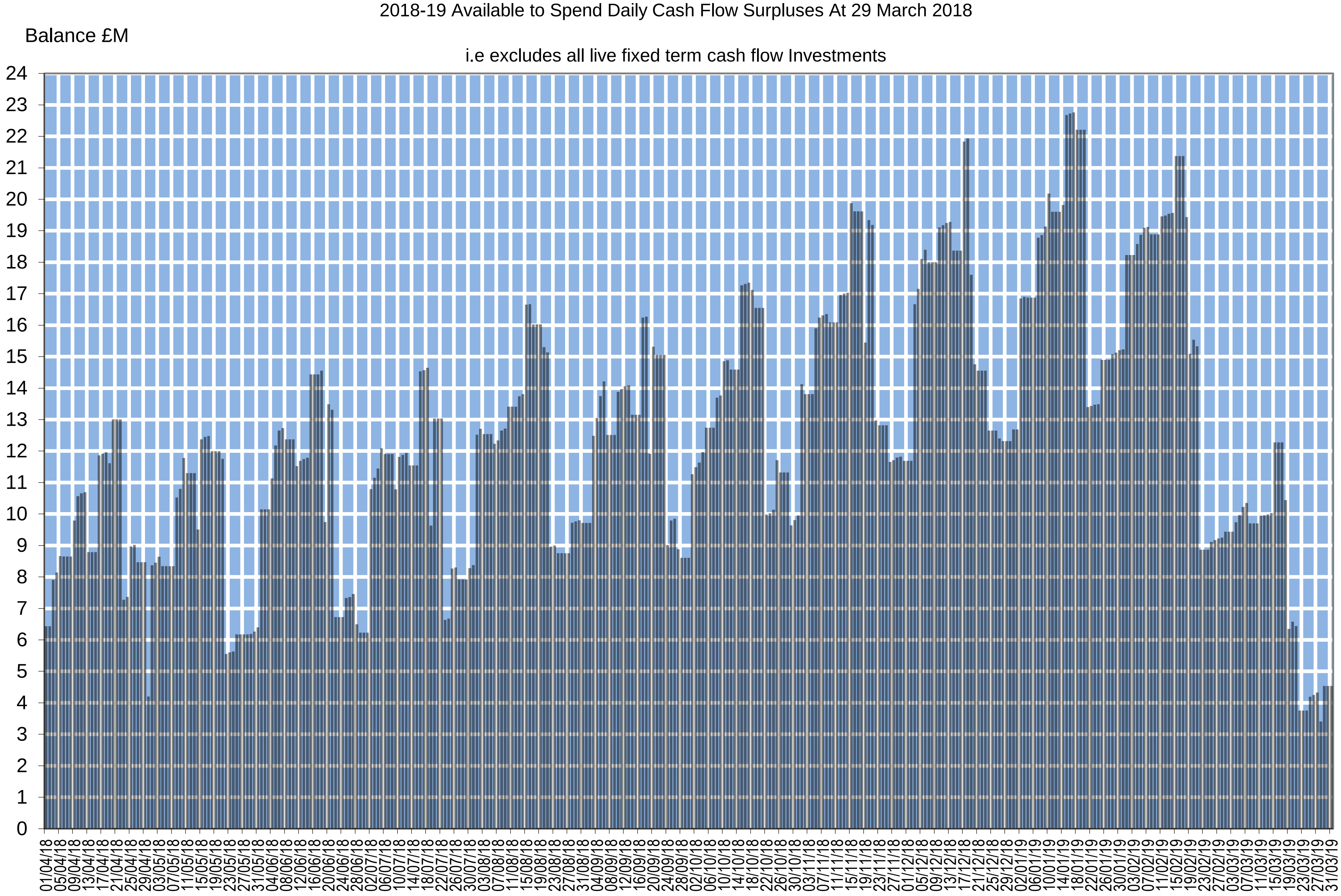
3) Note the 2017/18 outturn position.

Background papers: contact: Mike Withey

Link interest rate forecast (May 2018)
Link benchmarking data (March 2018)

Sharon Shelton
Director of Finance and Transformation

Annex 1



2018-19 Available to Spend Daily Cash Flow Surpluses At 29 March 2018
Balance £M
i.e excludes all live fixed term cash flow Investments

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Annex 2

Tonbridge and Malling Borough Council
Investment Summary as at 30 June 2018

Counterparty	Sovereign	Fitch Credit rating: Long Term	Fitch Credit rating: Short Term	Link Suggested Post CDS Duration Limit	Investment: Start Date	Investment: End Date	Investment: Duration	Investment: Amount Invested £	Investment: Return %	Investment: Proportion of total %	Instrument type / Product	Cash Flow Surpluses £	Core Cash Balances £	Long Term Investment Balances £
Bank of Scotland	UK	A+	F1	1 year	25/07/2017	25/07/2018	1 year	1,000,000	0.65%		Fixed Term		1,000,000	
Bank of Scotland	UK	A+	F1	1 year	01/09/2017	31/08/2018	1 year	1,000,000	0.65%		Fixed Term		1,000,000	
Bank of Scotland	UK	A+	F1	1 year	23/05/2018	23/05/2019	1 year	1,000,000	1.00%		Fixed Term		1,000,000	
Bank of Scotland Total								**3,000,000**		8.54%				
Barclays Bank	UK	A	F1	6 months	01/09/2017	17/08/2018	1 year	1,000,000	0.60%		CD		1,000,000	
Barclays Bank	UK	A	F1	6 months	20/06/2018	20/03/2019	9 months	1,000,000	0.73%		Fixed Term		1,000,000	
Barclays Bank Total								**2,000,000**		5.70%				
BNP Paribas MMF	n/a	AAA	mmf (Eq)	5 years	29/06/2018	02/07/2018	Overnight	5,139,000	0.53%		MMF	5,139,000		
BNP Paribas MMF Total								**5,139,000**		14.64%				
Federated MMF	n/a	AAA	mmf	5 years	29/06/2018	02/07/2018	Overnight	1,463,000	0.54%		MMF	1,463,000		
Federated MMF Total								**1,463,000**		4.17%				
Goldman Sachs Int'l Bank	UK	A	F1	6 months	21/03/2018	21/12/2018	9 months	2,000,000	1.13%		Fixed Term		2,000,000	
Goldman Sachs Int'l Bank	UK	A	F1	6 months	02/05/2018	04/02/2019	9 months	2,000,000	1.00%		Fixed Term		2,000,000	
Goldman Sachs Int'l Bank	UK	A	F1	6 months	20/06/2018	20/03/2019	9 months	2,000,000	0.97%		Fixed Term		2,000,000	
Goldman Sachs Int'l Bank Total								**6,000,000**		17.09%				
Lloyds Bank	UK	A+	F1	1 year	25/07/2017	25/07/2018	1 year	1,000,000	0.65%		Fixed Term		1,000,000	
Lloyds Bank	UK	A+	F1	1 year	15/05/2018	15/05/2019	1 year	2,000,000	1.00%		Fixed Term		2,000,000	
Lloyds Bank Total								**3,000,000**		8.54%				
Morgan Stanley MMF	n/a	AAA	mmf	5 years	29/06/2018	02/07/2018	Overnight	1,000,000	0.51%		MMF	1,000,000		
Morgan Stanley MMF Total								**1,000,000**		2.85%				
Hermes Property Unit Trust	n/a	n/a	n/a	n/a	29/09/2017	n/a	n/a	1,000,000	3.67%		Property Fund			1,000,000
Hermes Property Unit Trust Total								**1,000,000**		2.85%				
Local Authorities' Property Fund	n/a	n/a	n/a	n/a	29/06/2017	n/a	n/a	1,000,000	4.37%		Property Fund			1,000,000
Local Authorities' Property Fund	n/a	n/a	n/a	n/a	30/05/2018	n/a	n/a	1,000,000	3.97%		Property Fund			1,000,000
Local Authorities' Property Fund Total								**2,000,000**		5.70%				
Lothbury Property Trust	n/a	n/a	n/a	n/a	06/07/2017	n/a	n/a	1,000,000	3.11%		Property Fund			1,000,000
Lothbury Property Trust Total								**1,000,000**		2.85%				
National Westminster Deposit Account	UK	A-	F2	1 year	29/06/2018	02/07/2018	Overnight	10,000	0.05%		Call	10,000		
National Westminster Bank	UK	A-	F2	1 year	20/06/2018	20/03/2019	9 months	2,000,000	0.85%		CD		2,000,000	
National Westminster Bank	UK	A-	F2	1 year	29/06/2018	29/03/2019	9 months	2,000,000	0.88%		CD		2,000,000	
National Westminster Bank Total								**4,010,000**		11.42%				
Nordea Bank AB	Sweden	AA-	F1+	1 year	17/04/2018	17/07/2018	3 months	2,000,000	0.74%		CD		2,000,000	
Nordea Bank AB Total								**2,000,000**		5.70%				
Santander Deposit Account	UK	A	F1	6 months	29/06/2018	02/07/2018	Overnight	2,500,000	0.50%		Call	1,500,000	1,000,000	
Santander UK Plc Total								**2,500,000**		7.12%				
Standard Chartered Bank	UK	A+	F1	6 months	20/04/2018	19/10/2018	6 months	1,000,000	0.90%		CD		1,000,000	
Standard Chartered Bank Total								**1,000,000**		2.85%				
					Total invested			**35,112,000**		**100.00%**		**9,112,000**	**22,000,000**	**4,000,000**

Number of investments	25		**Average investment value £**		1,404,000
Number of counter parties	14		**Average counter party investment £**		2,508,000
Group exposures:		**Core £**	**Cash £**	**Combined £**	**%**
Royal Bank of Scotland + National Westminster (UK Nationalised 20%)		4,000,000	10,000	4,010,000	11.42
Bank of Scotland + Lloyds (20%)		6,000,000	-	6,000,000	17.09
				£	**%**
Property Funds Total [1]				4,000,000	11.39

Total non-specified investments should be less than 60% of Investment balances	11.39%

Notes:

[1] Additional £1m Lothbury Property Trust placed 2 July 2018.

CD = Certificate of Deposit, MMF = Money Market Fund.

Property Fund returns are indicative only and based on income distributed since the commencement of the investment. Capital appreciation / depreciation is recorded elsewhere.

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Tonbridge and Malling Borough Council Lending List

Checked against Link's Duration Matrix dated 29/06/18

Minimum investment criteria is Link's Green (100 days) Duration Band (entry point broadly equates to Fitch A-, F1 unless UK nationalised / semi-nationalised).

Counterparty	Sovereign	Sovereign Rating [1]	Fitch Long Term	Fitch Short Term	UK Classification	Exposure Limit	Link Duration [2] Credit Rating	Link Duration [2] Post CDS
Bank of Montreal	Canada	AAA	AA-	F1+	n/a	£6m	1 year	1 year
Toronto Dominion Bank	Canada	AAA	AA-	F1+	n/a	£6m	1 year	1 year
Danske Bank	Denmark	AAA	A	F1	n/a	£6m	6 months	6 months
Rabobank (Cooperatieve Rabobank U.A.)	Netherlands	AAA	AA-	F1+	n/a	£6m	1 year	1 year
ING Bank	Netherlands	AAA	A+	F1	n/a	£6m	1 year	1 year
Nordea Bank AB	Sweden	AAA	AA-	F1+	n/a	£6m	1 year	1 year
Svenska Handelsbanken AB	Sweden	AAA	AA	F1+	n/a	£6m	1 year	1 year
Bank of Scotland (Group limit BOS & Lloyds £6m)	UK	AA	A+	F1	Ring-fenced	£6m	1 year	1 year
Barclays Bank (Group Limit Barclays and Barclays UK £6m)	UK	AA	A	F1	Non-RF	£6m	6 months	6 months
Barclays Bank UK (Group Limit Barclays and Barclays UK £6m)	UK	AA	A	F1	Ring-fenced	£6m	6 months	6 months
Goldman Sachs Int'l Bank	UK	AA	A	F1	Exempt	£6m	6 months	6 months
HSBC Bank	UK	AA	AA-	F1+	To be determined	£6m	1 year	1 year
Lloyds Bank (Group limit BOS & Lloyds £6m)	UK	AA	A+	F1	Ring-fenced	£6m	1 year	1 year
Santander UK	UK	AA	A	F1	To be determined	£6m	6 months	6 months
Standard Chartered Bank	UK	AA	A+	F1	Exempt	£6m	6 months	6 months
Coventry Building Society	UK	AA	A	F1	Exempt	£6m	6 months	6 months
Nationwide Building Society	UK	AA	A	F1	Exempt	£6m	6 months	6 months
National Westminster Bank (Group limit Nat West and RBS £6m). UK Nationalised.	UK	AA	A-	F2	Ring-fenced	£6m	1 year	1 year
The Royal Bank of Scotland (Group limit Nat West and RBS £6m). UK Nationalised.	UK	AA	A-	F2	Ring-fenced	£6m	1 year	1 year
UK Debt Management Office including Treasury Bills	UK	AA	n/a	n/a	n/a	No limit	5 years	5 years
UK Treasury Sovereign Bonds (Gilts)	UK	AA	n/a	n/a	n/a	£15m (£7.5m	5 years	5 years
UK Local Authority (per authority)	UK	AA	n/a	n/a	n/a	£6m	5 years	5 years

[1] Reflects the lowest of the three rating agencies views (Fitch, Moody's and Standard and Poor's). Strategy requires sovereigns to be rated at least AA-. Non-UK sovereign limit of 20% or £6m.

[2] **All deposits overnight** unless otherwise **approved in advance** by the Director of Finance and Transformation **AND** Chief Financial Services Officer. If other than overnight, duration for non-UK entities must not exceed Link's post CDS duration assessment. For UK entities, duration may be extended by up to three months **based on credit ratings alone** or six months if **CDS is below average** subject to a maximum combined duration of 12 months.

Money Market Funds

Minimum investment criteria one of AAA-mf, AAAmmf or AAAm

Fund Name	Moody	Fitch	S&P	Exposure Limit
Blackrock	AAA-mf	-	AAAm	£6m
BNP Paribas	-	-	AAAm	£6m
Goldman Sachs	AAA-mf	AAAmmf	AAAm	£6m
Deutsche Fund	AAA-mf	AAAmmf	AAAm	£6m
Standard Life (Ignis)	-	AAAmmf	AAAm	£6m
Morgan Stanley	AAA-mf	AAAmmf	AAAm	£6m
Federated (Prime Rate)	-	AAAmmf	AAAm	£6m
Insight Liquidity Group limit IL & ILP of £6m	-	AAAmmf	AAAm	£6m

Enhanced Cash Funds

Minimum investment criteria AAA

Fund Name	Moody	Fitch	S&P	Exposure Limit
Insight Liquidity Plus Group limit IL & ILP £6m	-	-	AAAf /S1	£3m

Approved by Director of Finance and Transformation 2nd July 2018	No Change

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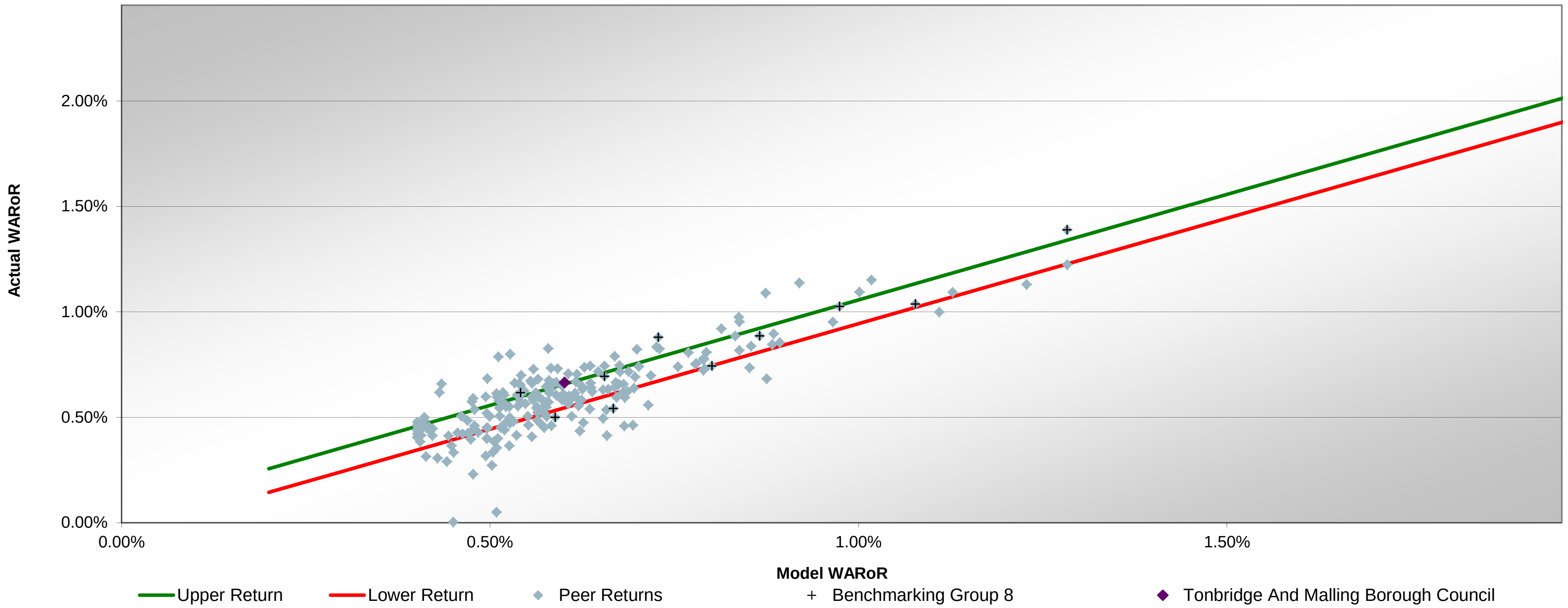
Tonbridge And Malling Borough Council

Population Returns against Model Returns 31 March 2018



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Tonbridge And Malling Borough Council	0.67%	0.60%	0.06%	0.54%	0.66%	Above

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Tonbridge and Malling Borough Council

Treasury Management Annual Report 2017/18

1.1 Introduction

1.1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activity and the actual prudential and treasury indicators for 2017/18. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.1.2 During 2017/18 the minimum reporting requirements were that full Council should receive the following reports:

- an annual treasury strategy in advance of the year;
- a mid-year treasury update; and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, treasury management updates have been presented to each meeting of the Audit Committee throughout the 2017/18 financial year. Treasury performance was also considered at the Finance, Innovation and Property Advisory Board through the regular Financial Planning and Control reports.

1.1.3 Changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

1.1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to full Council.

1.2 The Economy and Interest Rates

1.2.1 Bank of England forecasts following the June 2016 referendum anticipated a significant slowing of UK GDP growth. The Bank responded in August 2016 by cutting Bank Rate from 0.5% to 0.25% and making available over £100bn of cheap financing to the banking sector. Both measures were intended to stimulate growth in the economy. The forecasts now appear to have been overdone with the UK economy returning a G7 leading growth rate of 1.8% in 2016 followed by the same in 2017.

1.2.2 During 2017 there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth did weaken in the first half of 2017. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the referendum resulting in higher import costs. This caused a reduction in consumer disposable income as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weaker growth as consumers responded by reducing expenditure.

1.2.3 The September 2017 MPC meeting provided a shock to the markets with the tone in the minutes pointing to a Bank Rate increase in the near future. The November MPC quarterly Inflation Report meeting duly delivered withdrawing the 0.25% emergency rate cut implemented in 2016. The minutes from that meeting were viewed as dovish with little pressure to raise rates in the near term. In particular, GDP growth forecasts were again weak with little evidence of wage increase pressures despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching its 2% target as this was a one-off result of the devaluation of sterling following the referendum. The inflation forecast showed that the MPC expected inflation to come back to target (2%) over the next three years.

1.2.4 GDP growth in the second half of 2017 however came in stronger than expected and the start of 2018 saw evidence that wages were increasing at a faster pace. The February 2018 MPC meeting minutes revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift in their time horizon focusing on a two year time frame to manage inflation. This resulted in Markets anticipating a Bank Rate rise as early as May 2018.

1.3 Treasury Position at 31 March 2018

1.3.1 At the beginning and the end of 2017/18 the Council's debt and investment position was as follows:

	31 March 2017 £m	Rate / Return %	Average duration Days	31 March 2018 £m	Rate / Return %	Average duration Days
Variable rate debt:						
Overdraft	0.0	-	-	0.0	-	-
Total debt	**0.0**	-	-	**0.0**	-	-
Fixed rate investments:						
Cash flow surpluses	-	-	-	-	-	-
Core cash	17.0	0.69	118	13.0	0.80	118
Variable rate investments:						
Cash flow surpluses	6.1	0.50	61	6.4	0.47	3
Core cash	7.0	0.65	114	7.0	0.60	50
Sub-total	**30.1**	**0.64**	**105**	**26.4**	**0.67**	**72**
Long term investment						
Property Funds	-	-	-	3.0	3.73	-
Total investments	**30.1**	**0.64**	-	**29.4**	**1.47**	-

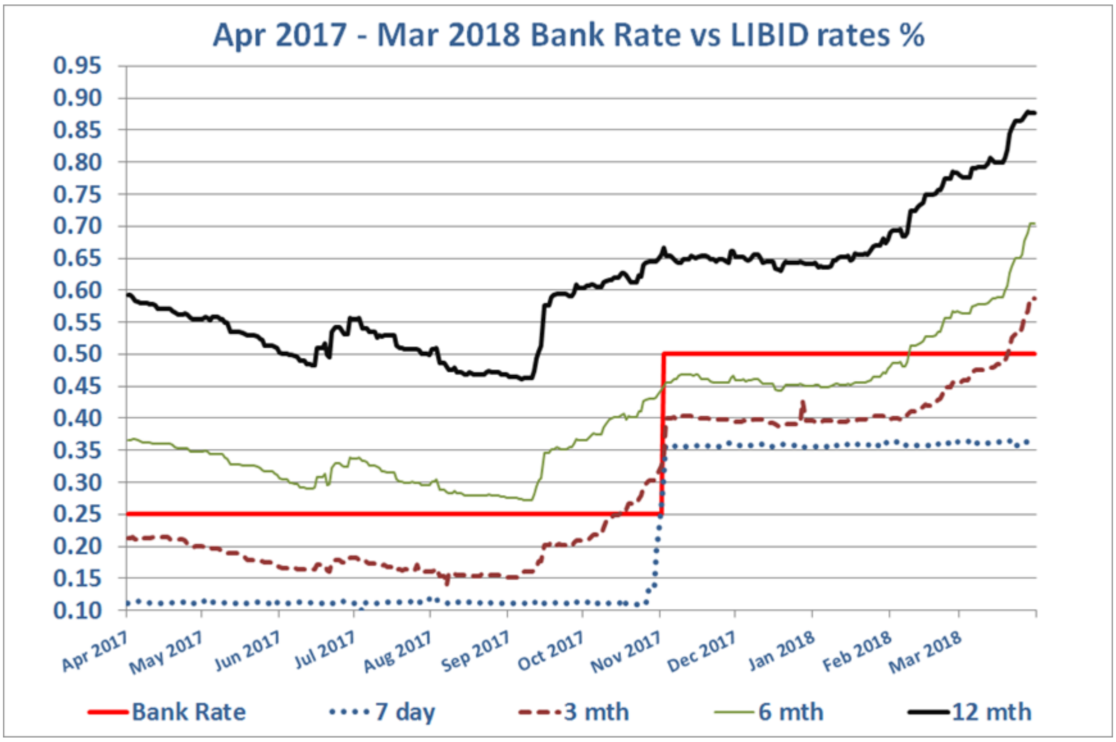
1.3.2 The modest fall in investment balances reflects use of the capital reserve (£1m) to finance capital expenditure offset by a rise in other reserves and balances reflecting savings against budget at outturn.

1.4 The Strategy for 2017/18

1.4.1 The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2, 2019 and then only increase once more before March 2020. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns.

1.5 Investment Rates in 2017/18

1.5.1 Rates offered by Banks for deposits continued at depressed levels at the start of 2017/18 due, in part, to a large tranche of cheap financing made available under the Bank of England's Term Funding Scheme. This facility ended in February 2018. Since mid-2017 investment rates for 3 months and longer began a rising trend in expectation of Bank Rate rising. Bank Rate was increased from 0.25% to 0.5% in November 2017. Further increases are expected over the next few years.



1.6 Investment Outturn for 2017/18

1.6.1 The Council's investment policy sets out the approach for choosing investment counter-parties and is based on credit ratings provided by the three main credit rating agencies. This is supplemented by additional market information including credit rating outlooks and credit default swap data (CDS). The

2017/18 Annual Investment Strategy was approved by Council in February 2017 and was subjected to a mid-year review in September 2017. In undertaking the review, no changes were made to the Council's minimum counter-party credit requirement (Fitch A-, F1 unless UK state owned) or counter-party exposure limits (maximum of 20% of funds for non-UK state owned financial institutions). Subject to a number of constraints, discretion to extend investment duration by up to six months over the Council's external treasury advisor's suggested duration was also retained.

1.6.2 **Cash flow investment**. In 2017/18 cash flow surpluses averaged £14.8m and earned an average rate of return of 0.47%. The average 7-day LIBID rate, used to compare performance, was 0.21%. Cash flow surpluses arise from the timing difference between the receipt of monies (from council tax, business rates, grants, etc.) and its subsequent payment (to precepting authorities, housing benefit recipients, suppliers, staff, etc.). Cash flow surpluses are required to meet regular payment obligations and as a consequence are invested in bank deposit accounts and money market funds which allow next day access. The opportunity to invest for longer durations and generate additional yield is taken when cash flow surpluses permit.

1.6.3 **Core cash investment**. In 2017/18 core cash averaged £21.9 and earned an average rate of return of 0.67%. The 3-month LIBID rate used as a comparator was 0.29%. Core cash comprises the authority's revenue and capital reserves. Unlike cash flow, core cash is not required to meet regular payment obligations and is available to invest for longer durations including durations exceeding one year. This added flexibility allows core cash to generate a better return relative to cash flow surpluses.

1.6.4 **Long term Investment**. The availability of cash balances over the longer term (10 years) and the suitability of different types of long term investment (equities, bonds and commercial property) was explored in the report to Audit Committee, January 2017. Of the alternatives, investment in property funds was considered best suited to meet the Council's more immediate funding need: a sustainable, stable income stream.

1.6.5 £2m of the Council's existing cash balances was identified for long term investment and applied to investment in property funds. A further £1m anticipated from the disposal of existing property assets has also been applied now, bringing the total investment in property funds during 2017/18 to £3m. Additional property fund investments are expected over time as funds become available from asset disposals and other windfalls.

1.6.6 In 2017/18 investment in property funds averaged £2m and earned an average rate of return of 3.73% excluding capital appreciation. In addition to the income stream the underlying value of each property fund investment showed steady growth. Subject to economic performance, the sale value of units is expected to exceed the purchase price some time during the 2018/19 financial year.

1.6.7 **Summary**. Investment performance for the financial year as a whole is summarised in the table below:

	2017/18 Average Balance £m	Return %	2017/18 Interest/ Dividends Earned £	2017/18 Revised Estimate £	Variance Better (worse) £
Cash flow surpluses	14.8	0.47	69,357	52,000	17,357
Core cash	21.9	0.67	147,722	144,000	3,722
Long term investment	2.0	3.73	74,643	80,000	(5,357)
		Total	291,722	276,000	15,722

1.6.8 The performance of the Authority's investments bettered the revised estimates by £15,722 (£165,722 when compared to the 2017/18 original estimates).

1.6.9 In finalising the Council's revised estimates, autumn 2017, the income estimate for cash flow was retained at its original level of £52,000, the return from core cash was increased from £74,000 to 144,000 and a new estimate to reflect income from property funds of £80,000 was introduced.

1.6.10 The significant increase in income from core cash reflected a combination of: higher than expected balances due to a delay by the Valuation Office in resolving outstanding business rate appeals; extending investment duration (higher proportion of 12 month deposits) and; managing cash flow and core cash balances in a more innovative way. Rather than opt for shorter duration cash flow investments as the financial year progressed (9 month investments at the start of the financial year, 6 months investments in the middle, 3 month investment towards the end) excess cash flow was transferred to core cash to take advantage of longer duration investments. Cash flow balances were then topped up towards the end of the financial year from available core cash maturities.

1.6.11 The improved performance for cash flow surpluses relative to the revised estimate (£69,357 actual vs £52,000 estimate) reflects the rapid improvement in money market fund returns following the Bank Rate rise November 2017.

1.7 Compliance with the Annual Investment Strategy

1.7.1 The Annual Investment Strategy aims to limit the Council's exposure to investment risks by prescribing: minimum counter-party credit criteria; maximum exposure limits in respect of sovereigns, counter-parties and group of related counter-party; the type of investment instrument that can be used; and investment duration limits. Throughout the period April 2017 to March 2018 the requirements set out in the Annual Investment Strategy for 2017/18, as approved by Council in February 2017, were complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2017/18.

1.8 MiFID II.

1.8.1 The Financial Conduct Authority (FCA) implementation of the European Union's second Markets in Financial Instruments Directive (MiFID II) commenced on 3 January 2018. The directive impacts on the way local authorities access financial services provided by banks, advisors, brokers and fund managers.

1.8.2 Under MiFID II, all local authorities are by default classified as 'retail clients' i.e. the same as a private individual. Those authorities that meet certain quantitative and qualitative criteria are able to opt-up to professional status. Professional status is considered vital to ensure the Council is able maintain adequate market access to ensure diversification, liquidity and yield can continue to be managed effectively.

1.8.3 Thirteen opt-up applications were submitted (autumn 2017) to the Council's money market funds, property funds, brokers and some banks / building societies. In response, twelve institutions classified the Council's treasury operation as 'elective professional'. The thirteenth application was sent to a building society and has yet to be determined.

1.9 Treasury and Prudential Codes of Practice

1.9.1 Updated Treasury Management and Prudential codes of practice were published by CIPFA on 21 December 2017. Whilst the codes apply to the 2018/19 financial year, given the timing of their release, CIPFA's Treasury and Capital Management Panel recommend the requirements of both Codes be 'implemented as soon as possible' and acknowledge that they may not be 'fully implemented until' the '2019/20 financial year'.

1.9.2 The Codes have been updated to address concerns arising from the Localism Act 2011 (commercialism agenda). The focus of both updates is to ensure the risks associated with investment in '**non-financial assets** which are held primarily for financial returns' are properly evaluated, reported, subject to scrutiny and managed over time. Non-financial assets will include the purchase of property to rent, shares and loans in subsidiaries or other outsourcing structures such as IT or building services providers.

1.9.3 The updated Codes will require amendment to the Council's Treasury Management Practices and Capital Strategy. Progress to ensure full compliance will be reported to Audit Committee during 2018.

Financial Services
May 2018

Prudential and Treasury Indicators

1 Prudential Indicators	2016/17 Actual £'000	2017/18 Original £'000	2017/18 Actual £'000
Capital expenditure	1,632	3,128	1,834
Ratio of financing costs to net revenue stream	-2.33%	-1.10%	-2.46%
Net borrowing requirement:			
Brought forward 1 April	nil	nil	nil
Carried forward 31 March	nil	nil	nil
In year borrowing requirement	nil	nil	nil
Capital financing requirement as at 31 March	nil	nil	nil
Annual change in capital financing requirement	nil	nil	nil
Incremental impact of capital investment decisions:			
Increase in Council Tax (Band D) per annum	£0.10	£0.48	£0.48

2 Treasury Management Indicators	2016/17 Actual £'000	2017/18 Original £'000	2017/18 Actual £'000
Authorised limit for external debt:			
Borrowing	nil	5,000	nil
Other long term liabilities	nil	nil	nil
Total	nil	5,000	nil
Operational boundary for external debt:			
Borrowing	nil	2,000	nil
Other long term liabilities	nil	nil	nil
Total	nil	2,000	nil
Actual external debt	nil	nil	nil
Upper limit for fixed rate exposure over one year at year end	nil	0 – 60%	nil
Upper limit for variable rate exposure under one year at the year end	13,098 (43.5%)	40 – 100%	13,434 (45.6%)
Upper limit for total principal sums invested for over 364 days	nil (0%)	60%	3,000 (10.2%)

3 Maturity structure of new fixed rate borrowing during 2017/18	Upper limit %	Lower limit %
Under 12 months	100	nil
Over 12 months	nil	nil

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