

**Tonbridge and Malling Borough Council****Treasury Management Annual Report 2018/19****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 2018/19. 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 2018/19 the minimum reporting requirements were that full Council should receive the following treasury reports:

- an annual strategy in advance of the year;
- a mid-year review; 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 2018/19 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 Economic Background**

1.2.1 After weak economic growth in the UK of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing economy in the G7 in quarter 4.

1.2.2 After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely

that Bank Rate would be cut to support growth. Nevertheless, MPC concerns have been increasing over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, excluding bonuses, in the three months to December before falling only marginally to 3.4% in the three months to January. Employers increased hiring at the fastest pace in more than three years in the three months to January 2019 as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

1.2.3 CPI inflation has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

1.2.4 The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

### 1.3 Treasury Position at 31 March 2019

1.3.1 At the beginning and the end of 2018/19 the Council's debt and investment position was as follows:

	31 March 2018 £m	Rate / Return %	Average duration Days	31 March 2019 £m	Rate / Return %	Average duration Days
Variable rate debt:						
Overdraft	0.0	-	-	0.0	-	-
<b>Total debt</b>	<b>0.0</b>	-	-	<b>0.0</b>	-	-
Fixed rate investments:						
Cash flow surpluses	-	-	-	-	-	-
Core cash	13.0	0.80	118	16.0	1.06	155
Variable rate investments:						
Cash flow surpluses	6.4	0.47	3	7.4	0.78	1
Core cash	7.0	0.60	50	8.0	1.06	219
Sub-total	26.4	0.67	72	31.4	0.99	134
Long term investments:						
Property Funds	3.0	3.73	-	5.0	3.55	-
<b>Total investments</b>	<b>29.4</b>	<b>1.47</b>	-	<b>36.4</b>	<b>2.04</b>	-

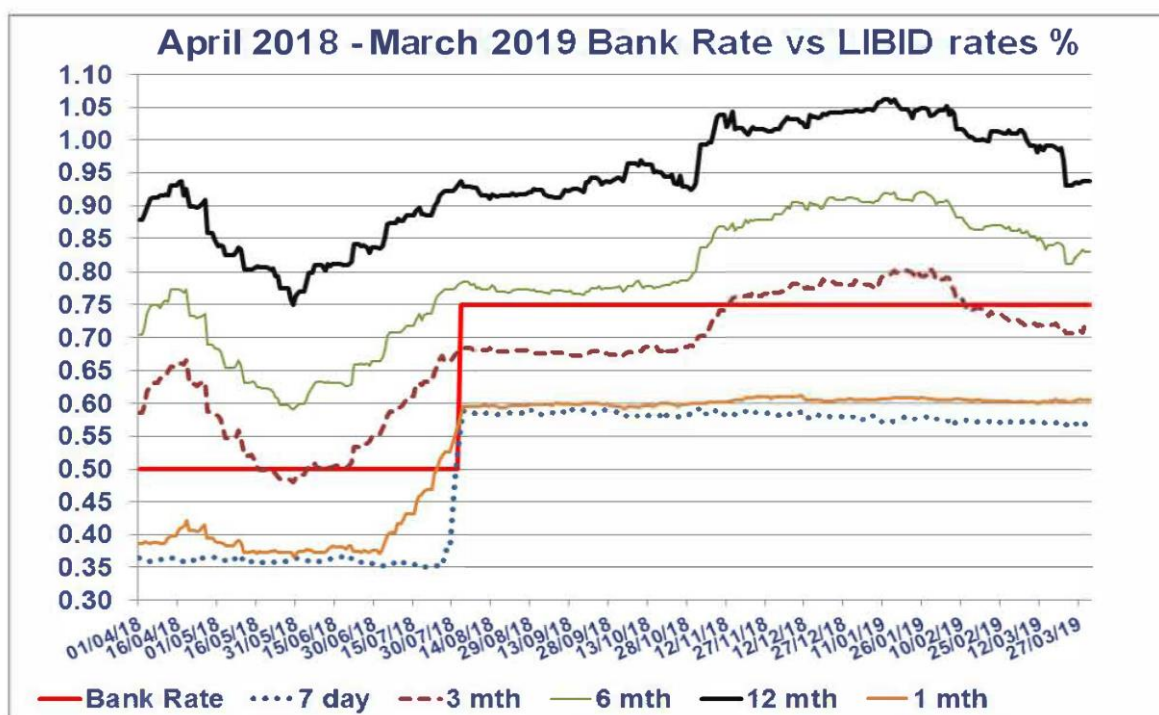
- 1.3.2 The rise in investment balances reflects: surpluses on business rates and council tax collection funds due to be distributed in 2019/20; unspent provisions for business rate appeals which have yet to be determined by the Valuation Office; reprogramming of some planned capital expenditure; lead authority for shared expenditure anticipated in 2019/20 (West Kent Partnership); and ad-hoc disposals used to part fund capital expenditure in 2018/19.

#### 1.4 The Strategy for 2018/19

- 1.4.1 In November 2017, the Bank of England returned the Bank rate to 0.5%. The expectation for interest rates within the treasury management strategy for 2018/19 anticipated the next rise in the Bank Rate in the fourth quarter of 2018. Bank Rate was increased to 0.75% in August 2018. The low interest rate environment and bank regulatory changes in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby term deposits with financial institutions would continue to be dominated by low counterparty risk considerations. Additional property fund investments would be undertaken from 'new money' that became available derived from the sale of existing property assets or other windfalls.

#### 1.5 Investment Rates in 2018/19

- 1.5.1 Rates offered by banks for deposits began to rise from their low point at the end of May 2018 in anticipation of the August Bank Rate rise. Since August, bank offers have continued to drift up wards peaking in January 2019. More recently offers have been declining in response to weaker economic growth in the UK, Brexit driven uncertainty and concerns for the global economy. Current market expectation is bank rate remaining at 0.75% before rising in 2020.



## 1.6 Investment Outturn for 2018/19

- 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 2018/19 Annual Investment Strategy was approved by Council in February 2018 and was subjected to a mid-year review in October 2018. 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 per financial institution). 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 2018/19 cash flow surpluses averaged £15.5m and earned an average rate of return of 0.73%. The average 7-day LIBID rate, used to compare performance, was 0.51%. 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 2018/19 core cash averaged £23.0m and earned an average rate of return of 0.91%. The 3-month LIBID rate used as a comparator was 0.68%. 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 At the start of the year £3m was invested in property investment funds and a further £2m invested during the year. Investment was spread across three funds to ensure, as far as is possible, stability of annual income and capital growth over time. Additional property fund investments are expected in the future as resources become available from asset disposals and other windfalls.
- 1.6.6 In 2018/19 investment in property funds averaged £4.6m and income of £162,908 was received which represents an annualised return of 3.55%.
- 1.6.7 Property funds issue and redeem primary units at a buy and sell price with the difference between the two prices reflecting the costs associated with buying

and selling 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. The table below compares the sale value of each investment if sold to the fund manager with the initial purchase price. Economic growth in the UK slowed in 2018/19 as did the rate at which fund sale values appreciated. A fall in sale values was recorded at some month ends especially during the second half of 2018/19. Nevertheless, since inception, the overall progress towards breakeven is still encouraging.

<b>Property fund</b> (Primary = units in the fund purchased from the fund manager. Secondary = units purchased from another investor at a discount. Date = first month the investment attracted dividends)	Purchase price  (a) £	Sale value at date of purchase  (b) £	Sale value March 2019  (c) £	March sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	973,300	(26,700)
Lothbury (Primary, July 2017)	1,000,000	927,700	975,900	(24,100)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	1,009,900	9,900
LAPF (Primary, June 2018)	1,000,000	922,200	933,200	(66,800)
Lothbury (Secondary, July 2018)	1,000,000	973,000	957,000	(43,000)
Total	5,000,000	4,684,100	4,849,300	(150,700)

1.6.8 **Summary.** Investment performance for the year 2018/19 is summarised in the table below:

	2018/19 Average balance  £m	Return  %	2018/19 Interest/dividends earned  £	2018/19 Revised Estimate  £	Variance Better (worse)  £
Cash flow surpluses	15.5	0.73	112,189	90,000	22,189
Core cash	23.0	0.91	210,690	190,000	20,690
Long term investment	4.6	3.55	162,908	172,000	(9,092)
Total	43.1	1.13	485,787	452,000	33,787

- 1.6.9 The overall performance of the Authority's investments bettered the revised estimates by £33,787 (£108,787 when compared to the 2018/19 original estimates).
- 1.6.10 In finalising the Council's revised estimates the income estimate for cash flow was increased from £58,000 to £90,000; the return from core cash was increased from £124,000 to 190,000; and income from property funds reduced from £195,000 to £172,000.
- 1.6.11 The original estimate assumed Bank Rate would rise December 2018. The increase in income from cash flow surpluses and core cash reflects the impact of an earlier than expected rise in Bank Rate in August 2018 in combination with higher than expected balances due to Valuation Office delays in processing business rate appeals. Higher than expected balances continued to year end. Reduced income from property funds reflects the revised timetable in respect of the sale of the River Walk Offices and a marginally lower return in 2018/19 compared to 2017/18 (3.55% vs 3.73%).

## 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 2018 to March 2019 the requirements set out in the Annual Investment Strategy for 2018/19, as approved by Council in February 2018, were complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2018/19.

## 1.8 Treasury and Prudential Codes of Practice

- 1.8.1 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 recommended the requirements of both Codes be 'implemented as soon as possible' and acknowledged that they may not be 'fully implemented until' the '2019/20 financial year'.
- 1.8.2 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.
- 1.8.3 Council adopted the December 2017 edition of the Codes in October 2018 and the requirements of the Codes have been taken into account and reflected as appropriate in this annual review and 2019/20 update of both the Capital Strategy and the Treasury Management and Annual Investment Strategy.

- 1.8.4 The Council has no material non-financial investments. Property funds, as opposed to directly owned property, are used as part of the Council's treasury management activity.

Financial Services  
May 2019

**Prudential and Treasury Indicators**

<b>1 Prudential Indicators</b>	2017/18 Actual £'000	2018/19 Original £'000	2018/19 Actual £'000
Capital expenditure	1,834	4,336	3,587
Ratio of financing costs to net revenue stream	-2.46%	-2.89%	-3.51%
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	£0.48	£0.20	£0.20

<b>2 Treasury Management Indicators</b>	2017/18 Actual £'000	2018/19 Original £'000	2018/19 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	13,434 (45.6%)	40 – 100%	15,411 (42.3%)
Upper limit for total principal sums invested for over 365 days	3,000 (10.2%)	60%	5,000 (13.7%)

<b>3 Maturity structure of new fixed rate borrowing during 2018/19</b>	Upper limit %	Lower limit %
Under 12 months	100	nil
Over 12 months	nil	nil