Annex 4

Tonbridge and Malling Borough Council

Treasury Management Annual Report 2019/20

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 2019/20. 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 2019/20 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 2019/20 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 Treasury Position at 31 March 2020

1.2.1 At the beginning and the end of 2019/20 the Council's debt and investment position was as follows:

	31 March 2019 £m	Rate / Return %	Average duration Days	31 March 2020 £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	-	-	-	2.0	0.20	13
Core cash	16.0	1.06	155	13.0	1.09	75
Variable rate investments:						
Cash flow surpluses	7.4	0.78	1	13.6	0.36	9
Core cash	8.0	1.06	219	6.0	0.56	76
Sub-total	31.4	0.99	134	34.6	0.66	46
Long term investments:						
Property Funds	5.0	3.55	-	5.0	3.54	-
Total investments	**36.4**	**2.04**	-	**39.6**	1.02	-

1.2.2 The rise in investment balances reflects: surpluses on business rates and council tax collection funds due to be distributed in 2020/21; unspent provisions for business rate appeals which have yet to be determined by the Valuation Office; and changes in the level of year-end debtor and creditor provisions.

1.3 The Strategy for 2019/20

1.3.1 Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was resolved, but would only rise to 1.0% during 2020

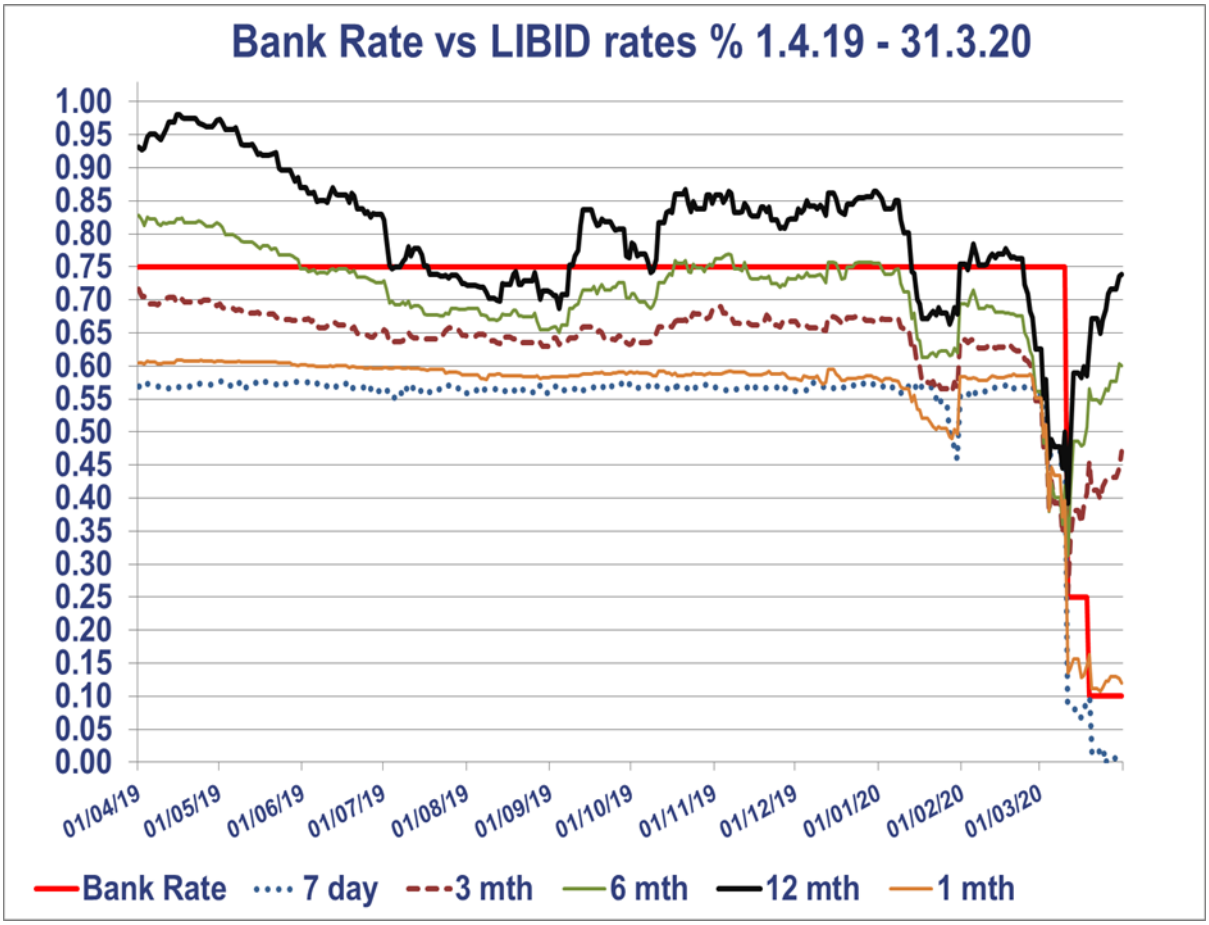
1.3.2 Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

1.3.3 While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the

financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme market stress and economic conditions.

1.4 Investment Rates in 2019/20

1.4.1 Bank rate and investment returns across durations up to 12 months are depicted in the graph below. The Bank Rate cut to 0.25% and then again to 0.1% during March 2020 to support the economy in response to Covid-19 is clearly visible.



1.5 Investment Outturn for 2019/20

1.5.1 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 2019/20 Annual Investment Strategy was approved by Council in February 2019 and was subjected to a mid-year review in October 2019. 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.

1.5.2 **Cash flow investment**. In 2019/20 cash flow surpluses averaged £19.9m and earned an average rate of return of 0.76%. The average 7-day LIBID rate, used to compare performance, was 0.53%. 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.

1.5.3 **Core cash investment**. In 2019/20 core cash averaged £25.1m and earned an average rate of return of 1.10%. The 3-month LIBID rate used as a comparator was 0.64%. 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.

1.5.4 **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.

1.5.5 This does not however, preclude consideration of an alternative investment opportunity that meets the Council's strategic priorities and objectives, achieves value for money and delivers a financial return commensurate with the Council's risk appetite. Each such opportunity to be considered on a case by case basis as appropriate.

1.5.6 At the start of the year £5m was invested in property investment funds and no further sums were 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 may be made in the future as resources become available from asset disposals and other windfalls.

1.5.7 In 2019/20 investment in property funds averaged £5.0m and income of £173,977 was received which represents an annualised return of 3.48%.

1.5.8 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.

Property fund (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 2020 (c) £	March sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	938,500	(61,500)
Lothbury (Primary, July 2017)	1,000,000	927,700	939,700	(60,300)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	994,900	(5,100)
LAPF (Primary, June 2018)	1,000,000	922,200	899,900	(100,100)
Lothbury (Secondary, July 2018)	1,000,000	973,000	921,600	(78,400)
Total	5,000,000	4,684,100	4,694,600	(305,400)

1.5.9 Fund capital values rose in 2017/18, were broadly static in 2018/19 and have fallen in 2019/20. The rise and fall mirrors the UK's GDP growth in those years. As a consequence of Covid-19 the UK economy is expected to falter in 2020/21 and further falls in capital values can be expected. Members are reminded that our property fund investments are long term (10 years) and the funds applied to them are not required to meet day to day spending commitments. Capital values are expected to rise over the long term as economic conditions improve.

1.5.10 **Summary**. Investment performance for the year 2019/20 is summarised in the table below:

	2019/20 Average balance £m	Return % 	2019/20 Interest/ dividends earned £	2019/20 Revised Estimate £	Variance Better (worse) £
Cash flow surpluses	19.9	0.76	150,734	125,000	25,734
Core cash	25.1	1.10	275,447	275,000	447
Long term investment	5.0	3.48	173,977	175,000	(1,023)
Total	50.0	1.20	600,158	575,000	25,158

1.5.11 The overall performance of the Authority's investments bettered the revised estimates by £25,158 (£117,158 when compared to the 2019/20 original estimates).

1.5.12 In finalising the Council's revised estimates the income estimate for cash flow was increased from £114,000 to £125,000; the return from core cash was increased from £169,000 to 275,000; and income from property funds reduced from £200,000 to £175,000.

1.5.13 The higher income from core cash, in particular, reflects higher than expected balances due to Valuation Office delays in processing business rate appeals.

1.6 Compliance with the Annual Investment Strategy

1.6.1 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 2019 to March 2020 the requirements set out in the Annual Investment Strategy for 2019/20, as approved by Council in February 2019, were complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2019/20.

1.7 Treasury and Prudential Codes of Practice

1.7.1 Updated Treasury Management and Prudential codes of practice were published by CIPFA on 21 December 2017.

1.7.2 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.

1.7.3 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.

1.7.4 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 2020

Annex 5

Prudential and Treasury Indicators

1 Prudential Indicators	2018/19 Actual £'000	2019/20 Original £'000	2019/20 Actual £'000
Capital expenditure	3,587	5,366	6,407
Ratio of financing costs to net revenue stream	-3.51%	-3.41%	-4.24%
Net borrowing requirement: Brought forward 1 April Carried forward 31 March In year borrowing requirement	 nil nil nil	 nil nil nil	 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	£0.20	£0.25	£0.25

2 Treasury Management Indicators	2018/19 Actual £'000	2019/20 Original £'000	2019/20 Actual £'000
Authorised limit for external debt: Borrowing Other long term liabilities Total	 nil nil nil	 5,000 nil 5,000	 nil nil nil
Operational boundary for external debt: Borrowing Other long term liabilities Total	 nil nil nil	 2,000 nil 2,000	 nil nil 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	15,411 (42.3%)	40 – 100%	19,610 (49.5%)
Upper limit for total principal sums invested for over 365 days	5,000 (13.7%)	60%	5,000 (12.6%)

3 Maturity structure of new fixed rate borrowing during 2019/20	Upper limit %	Lower limit %
Under 12 months	100	nil
Over 12 months	nil	nil