

TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

06 April 2021

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Information

1 TREASURY MANAGEMENT PERFORMANCE UPDATE

The report provides details of investments undertaken and the return achieved in the first eleven months of the current financial year. The progress made in securing a medium-term investment is also reported.

1.1 Introduction

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

1.2 Performance 1 April 2020 to 28 February 2021

1.2.1 A full list of investments held on 28 February 2021 is provided at **[Annex 1]** and a copy of our lending list is provided at **[Annex 2]**. The table below provides a summary of funds invested and income earned at the end of February.

	Funds invested at 28 Feb 2021 £m	Average duration to maturity Days	Weighted average rate of return %	Interest / dividends earned to 28 Feb 2021 £	Annualised return %	LIBID benchmark average from 1 April %
Cash flow	25.8	8	0.02	36,050	0.13	(0.07) 7Day
Core cash	16.0	108	0.40	86,850	0.54	0.02 3Month
Sub-total	41.8	46	0.17	122,900	0.28	(0.04) Ave
Long term	5.0		3.50	126,900	3.38	
Total	46.8		0.53	249,800	0.53	

Property funds pay dividends quarterly. The return quoted above is based on dividends received for the period April to December 2020 and on the return achieved since inception.

1.2.2 **Cash flow and core cash investments.** Interest earned of £122,900 from cash flow surpluses and core cash balances to the end of February is £2,100 better than the revised estimate for the same period. The authority also outperformed the LIBID benchmark by 32 basis points.

- 1.2.3 The benchmarking service provided by the Council's treasury advisor enables our performance to be gauged against Link's other local authority clients. An extract from the latest benchmarking data is provided at **[Annex 3]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. On 31 December 2020 the Council's return at 0.22% (purple diamond) was just below the local authority average of 0.24%. Based on the Council's exposure to credit / duration risk that return was in-line with Link's predicted return (between the green and red diagonal lines). The Council's risk exposure was also in-line with the local authority average.
- 1.2.4 **Long term investment.** Some 20% (£3m) of the Council's expected long term cash balances together with new money derived from the sale of assets and other windfalls is being invested in externally managed property funds. These investments generate an annual income stream and an expectation of capital appreciation over time sufficient to recoup fund entry and exit costs circa 8%.
- 1.2.5 Income from property funds of £126,900 has been received thus far in 2020/21 (quarter ending December 2020) which represents an annualised return of 3.38%. Income is £9,900 higher than the revised estimate for the same period.
- 1.2.6 Capital appreciation / depreciation is recorded in the table below. Commercial property values fell in the early part of 2020 as the economy suffered from the impact of Covid-19. In more recent months commercial property values have begun to rise again. All our property fund investments recorded capital appreciation in the period October 2020 to February 2021.

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) £	Current sale value February 2021 (c) £	Current sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	925,650	(74,350)
Lothbury (Primary, July 2017)	1,000,000	927,700	928,500	(71,500)
Hermes (Secondary, October 2017)	1,000,000	939,000	956,000	(44,000)
LAPF (Primary, June 2018)	1,000,000	922,200	887,500	(112,500)
Lothbury (Secondary, July 2018)	1,000,000	973,000	910,600	(89,400)
Total change in principal	5,000,000	4,684,100	4,608,250	(391,750)
Total dividends received to December 2020				539,550
Net benefit since inception				147,800

1.3 Medium-term Investment

- 1.3.1 The reports to Audit Committee in January 2018 and in January 2021 included commentary on diversified income (multi-asset) funds. Their use as an option for medium term investment (typically 5 years) has been included in recent annual investment strategies. Like our long-term (10 year) property fund investments, multi-asset funds aim to generate an above inflation return, negate volatility in capital values over the life of the investment and generate capital appreciation sufficient to recoup fund entry and exits costs. Recognising that these types of investment are unsuitable for short-term cash management purposes (maturities will be required to meet payment obligations) our strategy restricts the scale of investment to no more than 20% (£3m) of expected long term cash balances applied to medium-term investment and the same proportion applied to long-term investment.
- 1.3.2 Link, the Council's treasury advisor, has been engaged to source a suitable multi-asset fund (or funds) that strike an appropriate balance between risk and return and assist with the due diligence work that will need to be undertaken. The Council is aiming to achieve a return of 3% per annum, net of management fees, over a 5-year period. Link's engagement fee is £8,500 and is to be funded from a proportion of the excess income the investment will generate in 2021/22. The task is expected to take three months to complete and is scheduled to conclude in June 2021.
- 1.3.3 A proportion of any investment in a multi-asset fund will involve exposure to shares and bonds issued by companies. Environmental, social and corporate governance (ESG) issues will be explored as part of the fund selection process to ensure fund exposure takes due regard of such issues including the Council's adopted Climate Change Strategy.

1.4 Legal Implications

- 1.4.1 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 Asset Services are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.5 Financial and Value for Money Considerations

- 1.5.1 Our investment income estimates for 2020/21 were reduced by £237,000 when they were revised in January 2021. The reduction reflected the Bank Rate cut from 0.75% to 0.1% in March 2020 and a delay in the receipt of sale proceeds earmarked for additional property fund investment. The revised income total of £288,000 is expected to be achieved.

- 1.5.2 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.
- 1.5.3 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.
- 1.5.4 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.
- 1.5.5 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.
- 1.5.6 Diversified income funds aim to limit risk by spreading investment across a broad range of asset classes (equities, bonds, property and cash). Nevertheless, the principal sum invested may fall because of adverse economic conditions or market events.

1.6 Risk Assessment

- 1.6.1 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.

Background papers:

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Link Asset Services - benchmarking data.

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