Annex 4

Tonbridge and Malling Borough Council

Treasury Management Annual Report 2020/21

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 2020/21. 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 2020/21 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 2020/21 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 31 March 2021

1.2.1 At the beginning and the end of 2020/21 the Council's debt and investment position was as follows:

	31 March 2020 £m	Rate / Return %	Average duration Days	31 March 2021 £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	0.0	-	-
Core cash	13.0	1.09	75	8.0	0.38	134
Variable rate investments:						
Cash flow surpluses	13.6	0.36	9	15.8	0.04	7
Core cash	6.0	0.56	76	8.0	0.41	90
Sub-total	34.6	0.66	46	31.8	0.22	70
Long term investments:						
Property Funds	5.0	3.54	-	5.0	3.51	-
Total investments	**39.6**	**1.02**	-	**36.8**	**0.67**	-

1.2.2 The reduction in investment balances reflects surpluses / deficits on the council tax and business rates collection funds due to be paid / recovered in 2021/22; application of provisions to meet business rate appeals which were determined by the Valuation Office during the financial year; and changes in the level of year-end debtor and creditor provisions.

1.3 The Strategy for 2020/21

1.3.1 The treasury management strategy for 2020/21, based on November 2019 forecasts, assumed a trade agreement between the UK and EU would be reached. The beneficial impact on economic growth and upward inflationary pressure that would follow would see Bank Rate rising from 0.75% to 1.0% in March 2020. Bank rate was then expected to remain at 1.0% throughout 2020/21.

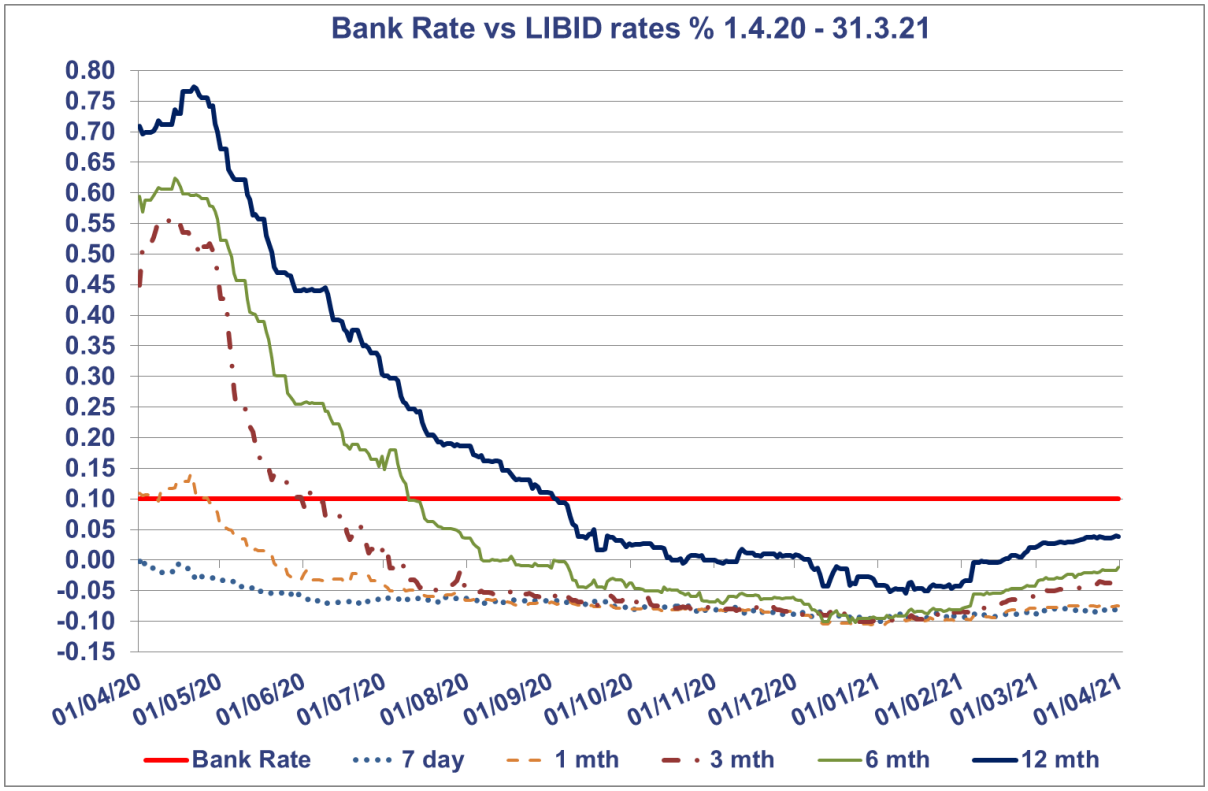
1.3.2 At the time the strategy was presented to Members is January 2020, Covid-19 didn't feature in news bulletins but by March 2020 the UK was in lockdown. The much hoped for short sharp shock to the economy followed by a rapid recovery, anticipated when lockdown commenced, didn't materialise. Governments and central banks responded to the pandemic with substantial support packages. Bank Rate is now expected to remain at its present level of 0.1% for some time to come. Link, the Council's treasury advisor, anticipate Bank Rate rising to 0.25% in September 2023 (forecast updated May 2021).

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 2020/21

1.4.1 Bank rate and investment returns across durations up to 12 months are depicted in the graph below. Bank Rate was cut from 0.75% to 0.10% in March 2020 to support the economy in response to Covid-19. Deposits rates from banks fell rapidly during the early part of 2020/21 with many short duration deposits (up to 6 months) attracting trivial, and in some cases, negative returns. Deposit rates available towards the end of the financial year showed little improvement.



1.5 Investment Outturn for 2020/21

1.5.1 The Council's investment policy sets out the approach for choosing investment counterparties 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 2020/21 Annual Investment Strategy was approved by Council in February 2020 and was subjected to a mid-year review in September 2020. In undertaking the review, no changes were made to the Council's minimum counter-party credit requirement (typically Fitch A-, F1 unless UK state owned) or counter-party exposure limits (maximum of 20% of funds per financial institution). Subject to constraints, discretion to extend investment duration for UK regulated financial

institutions 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 2020/21 cash flow surpluses averaged £29.3m and earned an average rate of return of 0.13%. The average 7-day LIBID rate, used to compare performance, was minus 0.07%. 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 Government, precepting authorities, housing benefit recipients, suppliers, staff, etc.). Cash flow surpluses are required to meet regular payment obligations and 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 2020/21 core cash averaged £17.4m and earned an average rate of return of 0.53%. The 3-month LIBID rate used as a comparator was 0.02%. 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 2020/21 investment in property funds averaged £5.0m and income of £172,177 was received which represents an annualised return of 3.42%.

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 2021 (c) £	March sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	931,800	(68,200)
Lothbury (Primary, July 2017)	1,000,000	927,700	926,500	(73,500)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	967,400	(32,600)
LAPF (Primary, June 2018)	1,000,000	922,200	893,500	(106,500)
Lothbury (Secondary, July 2018)	1,000,000	973,000	908,600	(91,400)
Total	5,000,000	4,684,100	4,627,800	(372,200)

1.5.9 Fund capital values rose in 2017/18, were broadly static in 2018/19 and 2019/20 until Covid-19 began to impact the economy. Capital values fell some 6% (£292,000) in the first nine months of 2020. However, since October 2020 fund values have been rising each month recouping some 40% (£116,000) of that decline. Capital values are expected to continue to rise over the long term as economic conditions improve. 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.

1.5.10 **Summary**. Investment performance for the year 2020/21 is summarised in the table below:

	2020/21 Average balance £m	Return % %	2020/21 Interest/ dividends earned £	2020/21 Revised Estimate £	Variance Better (worse) £
Cash flow surpluses	29.3	0.13	36,821	42,000	(5,179)
Core cash	17.4	0.53	91,955	90,000	1,955
Long term investment	5.0	3.42	172,177	156,000	16,177
Total	51.7	0.58	300,953	288,000	12,953

1.5.11 The overall performance of the Authority's investments bettered the revised estimates by £12,953 (and £224,047 less than the 2020/21 original estimates reflecting the impact of Covid-19 on investment returns).

1.5.12 In finalising the Council's revised estimates, the income estimate for cash flow was reduced from £105,000 to £42,000; the return from core cash was reduced from £209,000 to £90,000; and income from property funds reduced from £211,000 to £156,000.

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 counterparty credit criteria; maximum exposure limits in respect of sovereigns, counterparties, and groups of related counterparties; the type of investment instrument that can be used; and investment duration limits. Throughout the period April 2020 to March 2021 the requirements set out in the Annual Investment Strategy for 2020/21, as approved by Council in February 2020, were complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2020/21.

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 considered 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 2021

Annex 4

Prudential and Treasury Indicators

1 Prudential Indicators	2019/20 Actual £'000	2020/21 Original £'000	2020/21 Actual £'000
Capital expenditure	6,407	3,876	2,064
Ratio of financing costs to net revenue stream	-4.24%	-3.56%	-1.96%
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	£0.25	-£1.03	-£1.03

2 Treasury Management Indicators	2019/20 Actual £'000	2020/21 Original £'000	2020/21 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	19,610 (49.5%)	40 – 100%	23,794 (64.7%)
Upper limit for total principal sums invested for over 365 days	5,000 (12.6%)	60%	5,000 (13.6%)

3 Maturity structure of new fixed rate borrowing during 2020/21	Upper limit %	Lower limit %
Under 12 months	100	nil
Over 12 months	nil	nil