

TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

04 April 2022

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.

1.1 Introduction

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

1.2 Performance 1 April 2021 to 28 February 2022

1.2.1 A full list of investments held on 28 February 2022 is provided at **[Annex 1]** and 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 2022.

	Funds invested at 28 Feb 2022	Average duration to maturity	Weighted average rate of return	Interest / dividends earned to 28-Feb-22	Gross annualised return	SONIA benchmark (compounded) to 28-Feb-22
	£m	Days	%	£	%	%
Cash flow	34.0	4	0.3	20,336	0.09	0.32 (7 Day)
Core cash	24.0	84	0.41	55,921	0.30	0.14 (3 Mth)
Sub-total	58.0	37	0.34	76,257	0.19	-0.04 (Ave)
Long term	5.00			119,833	4.79	
Medium term	4.25			69,685	4.92	
Total	67.3			265,775	0.74	

Table 1

Property funds pay dividends quarterly. The return quoted above is based on dividends received for the period April to December 2021 and on the return achieved since inception.

- 1.2.2 **Cash flow and core cash investments.** Interest earned of £76,257 from cash flow surpluses and core cash balances to the end of February is £12,000 better than the revised estimate for the same period due to more favourable rates in the market. LIBID benchmark has been phased out since December 2021 and replaced with SONIA (Sterling Overnight Index Average). This reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions, in circumstances where risks are minimal. On reflection the authority has outperformed against the SONIA benchmark by 23 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 2021 the Council's return at 0.17% (purple diamond) was slightly lower than the local authority average of 0.21%. 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.** £5m of the Council's expected long term cash balances together with new money derived from the sale of assets and other windfalls is invested in externally managed property funds. These investments generate an annual income stream and an expectation of capital appreciation over time sufficient to at least recoup the fund entry and exit costs circa 8%.
- 1.2.5 Income from property funds of £119,833 has been received thus far in 2021/22 (quarter ending December 2021) which represents an annualised return of 4.79%. Income is £9,000 lower than the original budget for the same period.
- 1.2.6 Capital appreciation / depreciation is recorded in the table below. Commercial property values have continued to recover from the impact suffered from Covid-19. All the property fund investments recorded capital appreciation in the period April 2021 to February 2022.

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	Sale value at date of purchase	Sale value 31 December 2021	31 December sale value above (below) purchase price (c-a) £
	a	b	c	
	£	£	£	
LAPF (Primary, July 2017)	1,000,000	922,200	1,047,096	47,096
Lothbury (Primary, July 2017)	1,000,000	927,700	1,012,363	12,363
Hermes (Secondary, Oct 2017)	1,000,000	939,000	1,079,909	79,909
LAPF (Primary, June 2018)	1,000,000	922,200	1,003,955	3,955
Lothbury (Secondary, July 2018)	1,000,000	973,000	992,848	(7,152)
Total change in principal	5,000,000	4,684,100	5,136,171	136,171
			Total dividends received	622,950
			Net gain since inception	759,121

Table 3

1.3 Medium-term Investment

- 1.3.1 In 2021/22 £4.25m of the Council's expected medium term cash balances together with new money derived from the sale of asset has been invested in externally managed diversified income funds. These investments will generate an annual income stream and will provide capital appreciation over time.
- 1.3.2 The diversified income funds have generated £69,685 up to 28 February 2022 which represents an annualised return of 4.92%. Income is some £12,900 higher than anticipated against the revised budget for the same period.

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 2021/22 were increased by £46,000 when they were revised in January 2022. The increase reflects the introduction of diversified income funds. The revised income total of £296,000 is expected to be exceeded.
- 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 the externally managed property funds and diversified income funds 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 or diversified income 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 the 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 or rise with the cyclical nature of economic activity or 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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