TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

15 January 2024

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Cabinet - Council Decision

1 TREASURY MANAGEMENT UPDATE AND TREASURY MANAGEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2024/25

The report provides details of investments undertaken and return achieved in the first eight months of the current financial year and an introduction to the 2024/25 Treasury Management and Annual Investment Strategy. Members are invited to recommend adoption of the Strategy to Cabinet.

1.1 Introduction

1.1.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are 'affordable, prudent and sustainable'.

1.1.2 The Act also requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy. The latter sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.2 Interest Rate Forecast

1.2.1 The Bank Rate has held at 5.25%, which is expected to be the peak in the tightening cycle. Link's forecast used in the 2023/24 Investment Strategy assumed economic conditions would steadily climb and peak at around 4.5% before steadily reducing to 2.5% over the next three years.

1.2.2 Since the approval of the 2023/24 Strategy was published last February interest rates have continued to rise. Short, medium, and long dated gilts remained elevated, CPI inflation has reduced but remains the highest in the G7, and the UK labour market has proved challenging in terms of high vacancies and high wage growth.

1.2.3 As the growing drag from higher interest rates intensifies over the next six months, the economy is expected to continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. With CPI inflation past its peak and expected to decline further, the economy has got through the cost-of-living crisis without recession. Even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates are expected to bite harder soon. The Bank of England is expected to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

1.2.4 CPI inflation declined from 6.8% in July to 6.7% in August and September, being the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. CPI inflation continues to reduce and is reported at 3.9% in November 2023.

1.2.5 The UK labour market is continuing to ease with the number of vacancies being reported below one million. That is the first time it has fallen below one million since July 2021. The job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. However, the cooling labour market conditions have yet to feed through to an easing in wage growth.

1.2.6 Link's latest Bank Rate forecast, updated in December 2023, is included in **[Annex 5]** and anticipates the Bank Rate peaking at 5.25% in 2023/24 before reducing to 3.00% by March 2026.

1.3 Investment Performance

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

1.3.2 Cash flow surpluses are available on a temporary basis and the amount is mainly dependent on the timing of council tax and business rates collected and their payment to precept authorities and government. Less significant cash flows relate to receipt of grants, payments to housing benefit recipients, suppliers and staff. Cash flow surpluses build up during the course of a financial year and are spent by financial year end. Thus far in 2023/24 cash flow surpluses have averaged £30.2m.

1.3.3 The Authority also has £34m of core cash balances. These funds are for the most part available to invest for more than one year, albeit a proportion is usually transferred to cash flow towards the end of the financial year to top-up daily cash balances. Core cash includes the Council's capital and revenue reserves which are being consumed over time to meet capital expenditure and 'buy time' to enable the authority to deliver its revenue savings targets.

1.3.4 Cash flow and core cash balances also include sums to meet business rate appeals which are expected to be resolved in 2023/24 and future years.

1.3.5 Long term investment comprises £5m in property fund investments.

1.3.6 Medium term investment comprises £4.25m in diversified income fund investments.

1.3.7 A full list of investments held on 30 November 2023 is provided at **[Annex 1]** and a copy of our lending list of 30 November 2023 is provided at **[Annex 2]**. The table below provides a summary of funds invested and income earned at the end of November.

	Funds invested on 30 November 2023 £m	Average duration to maturity Days	Weighted average rate of return %	SONIA benchmark November 2023 %	Interest / dividends earned 1 April to 30 November 2023 £	Gross annualised return %
Cash flow	30.25	7	5.33	5.20	985,114	4.94
Core cash	34.00	172	5.80	5.24	974,319	5.57
Sub-total	**64.25**	**94**	**5.57**	**5.22**	**1,959,433**	**5.26**
Long term	5.00				92,939	3.72
Medium term	4.25				144,821	5.10
Total	**73.50**				**2,197,193**	**5.14**

Table 1

Property funds pay dividends quarterly. The return quoted above is based on dividends received for the period April to September 2023.

1.3.8 **Cash flow and core cash investments**. The SONIA benchmark above have slowly begun to pull back over the past few months (September rates: 5.28% & 5.39%). Market sentiment is for interest rate cuts in June 2024 and therefore the focus will be to secure investments for a longer duration (up to 12 months) to remain ahead of the curve.

1.3.9 Interest earned of £1,959,433 to the end of November is £1,209,441 above the original budget estimate for the same period. The increases in Bank Rates have been taken into consideration and updated figures have been included in the revised budget.

1.3.10 The Council takes advantage of Link's benchmarking service which enables performance to be gauged against Link's other local authority clients. An extract from the latest benchmarking data is provided in the form of a scatter graph at **[Annex 3]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. As at 30 September 2023 the Council's return was 5.47% (purple diamond) was above the local benchmarking group average of 5.11%. Link's predicted return is between the upper and lower boundary indicated by the diagonal lines. The Council's risk exposure was consistent with the local authority average.

1.3.11 Only cash flow and core cash returns form part of the benchmarking data. The additional return the Council makes from its property fund, and diversified income fund investments are not included. The data also excludes any short-term borrowing costs authorities may have incurred to meet payment obligations, however, no such costs have been incurred to date and none are anticipated during the remainder of 2023/24.

1.3.12 **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.

1.3.13 £3m was invested in property investment funds during 2017/18 and a further £2m invested during 2018/19. 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 could be made in the future as resources become available from asset disposals and other windfalls.

1.3.14 During the period 1 April 2023 to 30 September 2023 the £5m investment in property funds generated dividends of £92,939 which represents an annualised return of 3.72% (3.49% in 2022/23). Income from property funds is expected to be in line with the budget for the financial year as a whole.

1.3.15 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 / redemption of units avoided.

1.3.16 Although each property is unique, its value is informed by the sale of similar properties. During recession property transaction volumes diminish making valuation less certain. Each of our property fund managers attributed "uncertainty" to their monthly valuations during the summer. At the same time, and by regulation, when valuation is uncertain fund managers are required to suspend the purchase and redemption of units by investors. The suspension is intended to protect the interests of purchasers, sellers and continuing investors such as ourselves and was welcomed. Trading of shares has now resumed.

1.3.17 Sale values at the end of November vs initial purchase prices are as follows:

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 30 November 2023 C £	30 November 23 sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	894,946	(105,054)
Lothbury (Primary, July 2017)	1,000,000	927,700	765,067	(234,933)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	902,978	(97,022)
LAPF (Primary, June 2018)	1,000,000	922,200	858,074	(141,926)
Lothbury (Secondary, July 2018)	1,000,000	973,000	750,318	(249,682)
Total change in principal	5,000,000	4,684,100	4,171,383	**(828,617)**
			Total dividends received to September 2023	**1,009,756**
Table 2			**Net benefit since inception**	**181,139**

1.3.18 Since inception, the Council have received dividends from its property fund investments totalling £1,009,756. Commercial property values having momentarily recovered from the impact suffered from Covid-19, has faced new challenges including inflationary pressures. All property fund investments recorded capital depreciation in the period April 2023 to September 2023. The property funds continue to distribute dividends of which we have received £92,939 for the first six months of the year.

1.3.19 The Lothbury Property Trust was due to wind up on 31 December 2023 and have requested, by way of an EGM and unit holder vote, to be granted an extension until 31 March 2024 enabling them to pursue a merger option with a prospective fund which aligns well with Lothbury’s vision. If the fund thinks that the merger is a viable option, it would still be subject to a unit holder vote, which would need a 75% vote in favour to pass. Confirmation was received on Monday 18th December that 99.4% of the unit holders voted in favour of the extension.

1.3.20 If, however, the fund does get wound up, then all investors would be treated on an equal basis, i.e. the fund sells down assets and the income distributed back to investors on a pro-rata basis. The fund will continue to pay out distributions on live assets as it always has done.

1.3.21 The current situation with Lothbury could not have been foreseen and is due to a surge in redemptions which happened in a very short period of time, and was primarily related to pension funds invested in the fund who hold significant shares.

1.3.22 Members are reminded that higher yielding investments (e.g. property, equities) have the potential to fluctuate in value, both up and down. It is this feature which makes them unsuitable for short term investment where certainty over value at maturity is a key criteria. The Council’s property fund investments are not required to meet day to day spending commitments and will only be realised should a higher yielding opportunity be identified.

1.3.23 **Medium term investment**. In recent years multi asset (diversified income) funds have grown in popularity. The rational for adopting such a fund was explored in the Audit Committee report of January 2018 and their use for medium-term investment reaffirmed in the January 2021 Audit Committee report which introduced the multi asset (diversified income) funds into the Annual Investment Strategy.

1.3.24 Like property funds, multi asset (diversified income) funds aim to generate returns over and above inflation and thus preserve spending power.

1.3.25 A total of £4.25m was invested in 2021/22 between three funds chosen from the rigorous selection process, Fidelity Multi Asset Income Fund, Ninety-One Diversified Income Fund and Aegon Diversified Monthly Income Fund. It is expected that each fund will deliver a return in excess of 3% per annum and preserve capital over the five-year duration of the investment. Additional multi asset fund investments could be made in the future as resources become available from asset disposals and other windfalls.

1.3.26 During the period April 2023 to November 2023 the £4.25m investment in multi asset funds generated dividends of £144,821 which represents an annualised return of 5.10%.

1.3.27 **Treasury management function**. An extract from the <u>draft</u> income and expenditure estimates (*due to be presented to the Overview and Scrutiny Committee on 25 January*) attributed to the Treasury Management function are provided at **[Annex 4]**. This shows the aggregate staff resource applied to treasury management is less than one full time equivalent and that income exceeds costs by a significant margin. Income in future years forms part of the Council’s medium term financial strategy and is expected to decrease in the short term as Bank Rate pulls back. Expenditure is expected to rise in-line with inflation.

1.4 Annual Investment Strategy for 2024/25

1.4.1 The Council’s treasury advisors anticipate bank rate has peaked at 5.25% and is expected to hold for the next two quarters. It is anticipated that rates will steadily decrease, and by December 2025 the bank rate is anticipated to be 3.00%, where it will remain for the foreseeable future. Whilst there is no expectation of further rate rises, the Bank of England has again said that “further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures”, citing the rise in global bond yields and the upside risks to inflation from “energy prices given events in the Middle East”.

1.4.2 The Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates in the future.

1.4.3 CPI inflation declined from 6.8% in July to 6.7% in August and September, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.1%. That reverses all the rise since March. CPI inflation continues to reduce and is reported at 3.9% in November 2023.

1.4.4 The tightness of the UK labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

1.4.5 **Risk parameters**. The Strategy sets out the parameters that limit the Council’s exposure to investment risks by requiring overnight and term deposits to be placed with highly credit rated institutions and that those investments are diversified across a range of counterparties. Except where indicated by bold italic text, the 2024/25 Annual Investment Strategy **[Annex 5]** adopts the same risk parameters as currently approved. In summary these are:

- 100% of funds can be invested in the UK. Exposure to non-UK institutions is restricted to no more than 20% of funds per sovereign.

- Non-UK counterparties must be regulated by a sovereign rated AA- or higher as recognised by each of the three main rating agencies (Fitch, Moody’s or Standard & Poor’s).

- Investment in UK institutions is subject to the UK sovereign being rated A- or higher by each of the three main rating agencies. The UK currently receives a rating of AA- from Fitch and Moody's and AA from Standard and Poor's.

- Exposure to individual counterparties / groups of related counterparty must not exceed 20% of funds or ***10% of funds if a housing association***.

- In selecting suitable counterparties for overnight deposits and deposits up to 2 years in duration (3 years with a local authority), the Council has adopted Link's credit worthiness methodology. The methodology combines the output from all three credit rating agencies including credit watches / outlooks and credit default swap data to assign a durational band to a financial institution (100 days, 6 months, 1 year, 5 years, etc.). At the time of placing an investment the financial institution must be assigned a durational band of at least 100 days (based on credit ratings alone). Other than for UK nationalised institutions this broadly equates to a minimum long term credit rating of Fitch A- (high) and a short-term credit rating of Fitch F1 (highest).

- Investment in UK nationalised banks is subject to the bank having a minimum long term credit rating of Fitch BBB (good) and a short-term credit rating of Fitch F2 (good*)*. The Royal Bank of Scotland and National Westminster Bank are currently rated Fitch A+, F1.

- The duration of an investment in a foreign bank must not exceed Link's post CDS recommendation. For UK financial institutions Link's duration recommendation can be enhanced by up to 6 months subject to the combined duration (Link recommendation plus the enhancement) not exceeding 12 months. The Council's Treasury Management Practices have been modified to ensure that where duration is being enhanced by more than 3 months the bank's CDS must be below the average for all other banks at the time the investment is placed.

- Money Market funds will be AAA rated and exposure limited to no more that 20% per fund. LVNAV (low volatility) or VNAV (variable net asset value) funds may be used as an alternative to CNAV (constant net asset value) funds.

- Enhanced cash and Government liquidity funds will be AAA rated and ***ultra-short duration bond funds rated AA or higher***. Exposure is limited to no more than 10% of investment balances per fund and 20% to all such funds.

- Exposure to non-credit rated property funds is limited to no more than 20% (£3m) of expected long term cash balances. No limit applies where invested funds are derived from or in anticipation of new resources e.g. proceeds from selling existing property.

- Exposure to non-credit rated diversified income (multi-asset) funds ***and or short dated bond funds*** is limited to no more than 20% (£3m) of expected long term cash balances per fund and across all such funds.

- The strategy also limits the type of instrument (e.g. fixed term deposits, certificates of deposit, commercial paper, floating rate notes, treasury bills, etc.) that can be used and establishes a maximum investment duration for Gilts of 5 years, 3 years for deposits with local authorities and 2 years for all other types of investment other than investment in property funds, diversified income funds and ***short dated bond funds***.

1.4.6 The strategy includes prudential indicators for borrowing. Whilst there is no expectation, *based on the current capital plan*, that the Council will need to borrow to fund its capital expenditure proposals prior to 2029/30, borrowing on a temporary basis may be required to meet payment obligations. Borrowing limits are expressed as the operational limit (£4m) and authorised limit (£7m). Our largest monthly outflows relate to business rates (£5m) and precept payments (£8.2m). Whilst those payments tend to fall on different days of the month that is not always the case. The limits are a precautionary measure to allow borrowing on a short-term basis should the need arise. In recent years, the Council's cash flows have been managed in such a way that no overdraft fees or temporary borrowing costs have arisen.

1.4.7 The cooling in labour market conditions has yet to feed through to an easing in wage growth. The headline 3myy rate rose 7.8% for the period June to August, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular annual average total pay growth for the private sector was 7.1% in June to August 2023, for the public sector this was 12.5% and is the highest total pay annual growth rate since comparable records began in 2001. However, this is affected by the NHS and civil service one-off non-consolidated payments made in June, July and August 2023. The Bank of England's prediction was for private sector wage growth to fall to 6.9% in September.

1.4.8 The returns on our **property fund investments**, though representing only 6.80% of 2023/24 investment portfolio, are likely to generate a similar percentage next year due to the elevated bank rate on offer, this is expected to adjust in future years and will represent a high percentage of future income. The property fund investments are long term (10 year) investments. As a consequence of the high entry / exit costs (circa 8%) and potential for significant volatility in capital values, our strategy limits exposure to property funds from existing resources to 20% of expected long term balances, circa £3m per fund.

1.4.9 The returns on our **diversified income fund investments**, though representing only 5.78% of 2023/24 investment portfolio, are likely to generate a similar percentage next year due to the elevated bank rate on offer, this is expected to adjust in future years and will represent a high percentage of future income. The diversified income fund investments are medium term (5 year) investments. As a consequence of the potential for significant volatility in capital values, our strategy limits exposure to diversified income funds from existing resources to 20% of expected long term balances, circa £3m per fund.

1.4.10 Diversified income fund investment typically implies a 5-year commitment to negate volatility in capital values over the life of the investment.

1.4.11 The changes to the 2024/25 strategy include the updated position of the UK Sovereign Rating, **[Annex 5, 10.1].** The treasury team continuously monitor the market for potential investment which may align with the Council's strategic plans, and which would provide additional revenue streams.

1.4.12 **Risk parameters**. The Strategy sets out the parameters that limit the Council's exposure to investment risks by requiring overnight and term deposits to be placed with highly credit rated institutions and that those investments are diversified across a range of counterparties. The 2024/25 Annual Investment Strategy **[Annex 5]** adopts the same risk parameters as currently approved. In summary these are:

- 100% of funds can be invested in the UK. Exposure to non-UK institutions is restricted to no more than 20% of funds per sovereign.

- Non-UK counterparties must be regulated by a sovereign rated AA- or higher as recognised by each of the three main rating agencies (Fitch, Moody's or Standard & Poor's).

- Investment in UK institutions is subject to the UK sovereign being rated A- or higher by each of the three main rating agencies. Following a review in April 2023 by the three agencies, the UK Sovereign debt rating was placed on Stable Outlook. Accordingly, this Authority has agreed to reinstate the minimum rating of A- for the UK. The UK currently receives a rating of AA- from Fitch, AA3 from Moody's and AA from Standard and Poor's.

- Exposure to individual counterparties / groups of related counterparty must not exceed 20% of funds or 10% of funds if a housing association.

- In selecting suitable counterparties for overnight deposits and deposits up to 2 years in duration (3 years with a local authority), the Council has adopted Link's credit worthiness methodology. The methodology combines the output from all three credit rating agencies including credit watches / outlooks and credit default swap data to assign a durational band to a financial institution (100 days, 6 months, 1 year, 5 years, etc.). At the time of placing an investment the financial institution must be assigned a durational band of at least 100 days (based on credit ratings alone). Other than for UK nationalised institutions this broadly equates to a minimum long term credit rating of Fitch A- (high) and a short term credit rating of Fitch F1 (highest).

- Investment in UK nationalised banks is subject to the bank having a minimum long term credit rating of Fitch BBB (good) and a short term credit rating of Fitch F2 (good). The Royal Bank of Scotland and National Westminster Bank are currently rated Fitch A+, F1.

- The duration of an investment in a foreign bank must not exceed Link's post CDS recommendation. For UK financial institutions Link's duration recommendation can be enhanced by up to 6 months subject to the combined duration (Link recommendation plus the enhancement) not exceeding 12 months. The Council's Treasury Management Practices have been modified to ensure that where duration is being enhanced by more than 3 months the bank's CDS must be below the average for all other banks at the time the investment is placed.

- Money Market funds will be AAA rated and exposure limited to no more that 20% per fund. LVNAV (low volatility) or VNAV (variable net asset value) funds may be used as an alternative to CNAV (constant net asset value) funds.

- Enhanced cash and Government liquidity funds will be AAA rated and ultra-short duration bond funds rated AA or higher. Exposure is limited to no more than 10% of investment balances per fund and 20% to all such funds.

- Exposure to non-credit rated property funds is limited to no more than 20% (£3m) of expected long term cash balances. No limit applies where invested funds are derived from or in anticipation of new resources e.g. proceeds from selling existing property.

- Exposure to non-credit rated diversified income (multi-asset) funds and or short dated bond funds is limited to no more than 20% (£3m) of expected long term cash balances per fund and across all such funds.

- The strategy also limits the type of instrument (e.g. fixed term deposits, certificates of deposit, commercial paper, floating rate notes, treasury bills, etc.) that can be used and establishes a maximum investment duration for Gilts of 5 years, 3 years for deposits with local authorities and 2 years for all other types of investment other than investment in property funds, diversified income funds and short dated bond funds.

- The strategy includes prudential indicators for borrowing. Whilst there is no expectation that the Council will need to borrow to fund its ongoing capital expenditure proposals (as set out in the current capital plan) prior to 2029/30, borrowing on a temporary basis may be required to meet payment obligations. Borrowing limits are expressed as the operational limit (£4m) and authorised limit (£7m). Our largest monthly outflows relate to business rates (£5m) and precept payments (£8.2m). Whilst those payments tend to fall on different days of the month that is not always the case. The limits are a precautionary measure to allow borrowing on a short term basis should the need arise. In recent years the Council's cash flows have been managed in such a way that no overdraft fees or temporary borrowing costs have arisen.

1.4.13 The 2024/25 Strategy **[Annex 5]** reflects the current economic environment, Link Asset Services' latest interest rate forecast and incorporates the risk parameters summarised in paragraph 1.4.5.

1.5 Non-treasury Management Practices

1.5.1 The authority is currently debt free, and no borrowing is forecast to meet the ongoing Council's capital expenditure proposals (based on the current capital plan) prior to 2029/30. This does not however, preclude a decision to borrow in order to fund in full or in part an investment opportunity that meets the Council's strategic priorities and objectives, and achieves value for money. Each such opportunity to be considered on a case by case basis as appropriate.

1.5.2 At present the Council has no material non-treasury investments, e.g. expenditure on loans or the acquisition of non-financial assets (property) intended to generate a profit. The report to Audit Committee 20 January 2020 made reference to procedures that would need to be adopted to ensure compliance with the Chartered Institute of Public Finance & Accountancy's Treasury Management and Prudential Codes of Practice 2017 and the 2018 Statutory Guidance on Local Government Investments relating to non-treasury investments. Accordingly, a practice note was prepared and endorsed at the Audit Committee meeting in January 2021 and is attached at **[Annex 6]** for information.

1.6 Legal Implications

1.6.1 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.

1.6.2 This report fulfils the requirements of the Chartered Institute of Public Finance & Accountancy's Treasury Management and Prudential Codes of Practice 2017 and the 2018 Statutory Guidance on Local Government Investments. Please note, both Codes have been updated in December 2021 and have been taken into account in the 2024/25 Treasury Management and Annual Investment Strategy.

1.7 Financial and Value for Money Considerations

1.7.1 The Bank Rate is currently 5.25%. Link's current forecast (December 2023) anticipates Bank Rate have peaked at 5.25% and will start to fall back by June 2024. Longer term the rates are expected to fall back to 3.00% and remain there for the foreseeable future.

1.7.2 Following the interest rates increases over the past several months the investment income at the end of November 2023 (month eight of the financial year) from cash flow surpluses and core cash investments exceeds the original budget for the same period by £1,209,440. Income from property funds at the end of September 2023 is in line with the original budget for the same period. Investment income from multi-asset funds has generated £144,820 of income, and is some £40,000 in excess of the original budget. Investment income for the year as a whole is expected to exceed the original budget by £1,729,000.

1.7.3 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.

1.7.4 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.

1.7.5 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.

1.7.6 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.

1.7.7 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 as a consequence of adverse economic or market events.

1.7.8 Short term bond values are linked to interest rate expectations and long-term bond values are linked to inflation expectations. Funds aim to minimise the risk of issuer default by investing in a broad spread of issuers and across different sectors and geographic regions. Nevertheless, the principal sum invested may fall as a consequence of adverse economic or market events.

1.8 Risk Assessment

1.8.1 Link Asset Services are employed to provide advice on the content of the Treasury Management and Annual Investment Strategy and this, coupled with a regular audit of treasury activities ensures that the requirements of the Strategy and the Treasury Policy Statement adopted by this Council are complied with.

1.8.2 Credit ratings remain a key tool in assessing risk. It is recognised that their use should be supplemented with sovereign ratings and market intelligence. Appropriate sovereign, group and counterparty limits are established to ensure an appropriate level of diversification.

1.8.3 In the light of these safeguards and stringent Treasury Management Procedures it is considered that any risks to the authority implicit in the 2024/25 Strategy have been minimised.

1.9 Equality Impact Assessment

1.9.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

1.10 Recommendations

1.10.1 Members are invited to **RECOMMEND** that Cabinet:

1) Note the treasury management position as at 30 November 2023.

2) Adopts the Treasury Management and Annual Investment Strategy for 2024/25 set out at **[Annex 5]**.

Background papers: contact: Donna Riley

Link Asset Services: Interest rate forecast (December 2023), economic commentary and benchmarking data.

Sharon Shelton
Director of Finance and Transformation