

**TONBRIDGE & MALLING BOROUGH COUNCIL**

**AUDIT COMMITTEE**

**15 April 2024**

**Report of the Director of Finance and Transformation**

**Part 1- Public**

**Delegated**

**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. It also makes proposals in respect of the Lothbury Property Investment Fund.**

**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 2023 to 29 February 2024**

1.2.1 A full list of investments held on 29 February 2024 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 2024.

	Funds invested on 29 February 2024	Average duration to maturity	Weighted average rate of return	SONIA benchmark February 2024	Interest / dividends earned	Gross annualised return
	£m	Days	%	%	1 April to 29 February 2024 £	%
Cash flow	27.63	8	5.28	5.20	1,458,690	4.82
Core cash	35.00	186	5.67	5.21	1,473,070	5.80
<b>Sub-total</b>	<b>62.63</b>	<b>107</b>	<b>5.50</b>	<b>5.21</b>	<b>2,931,760</b>	<b>5.27</b>
Long term	5.00				136,970	3.65
Medium term	4.25				191,930	4.92
<b>Total</b>	<b>71.88</b>				<b>3,260,660</b>	<b>5.15</b>

Table 1

*Property funds pay dividends quarterly. The return quoted above is based on dividends received for the period April to December 2023 and on the return achieved since inception.*

- 1.2.2 **Cash flow and core cash investments.** Interest earned of £2,931,760 from surplus cash flow and core cash balances to the end of February has exceeded expectation when compared to the revised estimate for the same period. This is due to the interest rates remaining elevated for longer than anticipated, and provides the authority with the opportunity to continue investing at the favourable rates currently available.
- 1.2.3 Members are advised that a forward deal for £3m with Close Brothers was agreed to commence in February 2024. Since agreeing the deal, and due to the current investigation by the FSA into motoring industry loans, Close Brother's long term rating has been downgraded. The short term rating remains unaltered. The situation will be closely monitored, and any emerging information will form part of the treasury updates while the deal remains active.
- 1.2.4 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 2023 the Council's return at 5.53% (purple diamond) was higher than the local authority average of 5.22%. Based on the Council's exposure to credit / duration risk the return was above Link's predicted return (between the green and red diagonal lines). The Council's risk exposure remained in-line with the local authority average.
- 1.2.5 **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%.
- 1.2.6 Income from property funds of £136,970 has been generated thus far in 2023/24 (quarter ending December 2023) which represents an annualised return of 3.65%. Income is in line with the original budget for the same period.
- 1.2.7 In previous reports, Members have been advised of the potential wind-up / merger options for the Lothbury property Fund.
- 1.2.8 The latest position is that the Lothbury Property Trust was granted an extension until 31 March 2024 to pursue a merger option and subsequently asked for a further extension to 30 June to continue discussions. The second unit holder vote fell short of the required vote to pass the extension.
- 1.2.9 A further vote was tabled on 28 March to provide investors with an alternative to redemption by way of exchanging their units into the new Fund. The result of the vote was 81.8% in favour of the resolution and therefore successfully passed.

- 1.2.10 Subsequent to the outcome of this vote, officers contacted Lothbury for clarification on any exit fees due should TMBC decide not to transfer to the new fund. Members are aware that 'exit fees' are payable if an organisation decides to redeem an investment – usually around 2% of the value of the investment (in this case circa £40k). However, due to these unusual circumstances, Lothbury have confirmed that, should TMBC decide to disinvest at this time and not proceed to the new fund, there would be no exit fees payable prior to the deadline of 1 May 2024.
- 1.2.11 Cabinet on 2 April endorsed the recommendations from the Finance, Regeneration and Property Scrutiny Select Committee regarding Phase 2 of the Tonbridge Town Centre Asset Review. As Members fully appreciate, in order to finance the costs of this work (including the provision of a new build leisure centre) the Council will need to corral different sources of funding including: potential liquidation of long term investments, external funding such as developer contributions, potential reallocation of existing reserves and ultimately borrowing.
- 1.2.12 Therefore, there is an opportunity at this point for TMBC to consider redemption of this particular property investment fund to avoid payment of 'exit fees'. It should be noted that the redemption is not 'instantaneous' and would take some months (possibly as much as 12 to 18 months) to complete given that assets would need to be sold in order to repay investors. Once the monies are received, sums can be placed in shorter term deposits (which as Members will note are current generating good returns in any event).
- 1.2.13 Any capital loss on the disinvestment would need to be recognised in the Council's financial statements once the funds have been received. Capital losses (if and as applicable) would then be financed from an earmarked reserve specifically set up for this purpose.
- 1.2.14 In summary, therefore, this does present the Council with an opportunity to redeem a long term investment - which will be needed to be redeemed in due course in any event to support the major regeneration project. In an ideal world of course we would not wish to redeem until the property market, which moves in peaks and troughs, was at a peak. At the moment, as Members will note, there has been a reduction in property values which could lead to a capital loss on redemption (albeit that we have an earmarked reserve specifically to offset losses). However, it is impossible to predict when the property market might fully recover and thereby negate any capital losses recorded.
- 1.2.15 Under the Council's constitution, the Director of Finance & Transformation has delegated authority "*to undertake matters relating to treasury management subject to compliance with the Council's Treasury Management Strategy Statement and Annual Investment Strategy*" (DFT 111). This is a difficult call given the current market and the future uncertainty, but ON BALANCE officers' recommendation is that, given the significant regeneration plans the Council is progressing and the need to liquidate funds in the not too distant future, the redemption opportunity is registered in advance of the deadline of 1 May 2024.

1.2.16 Members are asked to support the proposed redemption from the Lothbury Property Fund as advised by officers. The Cabinet Member for Finance & Housing has been consulted and is supportive of the proposal given the circumstances outlined.

1.2.17 Capital appreciation / depreciation is recorded in the table below. The Property Portfolios continue to face challenges which are reflected in the capital values below. Fund compositions are evolving in favour of student accommodation and industrial and disinvesting from sectors such as office and retail. All the property fund investments recorded capital depreciation in the period April 2023 to February 2024.

<b>Property fund</b>	Purchase price	Sale value at date of purchase	Sale value 29 February 2024	29 February 24 sale value above (below) purchase price (c-a)
(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)	a	b	c	price (c-a)
	£	£	£	£
LAPF (Primary, July 2017)	1,000,000	922,200	880,900	(119,100)
Lothbury (Primary, July 2017)	1,000,000	927,700	735,500	(264,500)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	892,200	(107,800)
LAPF (Primary, June 2018)	1,000,000	922,200	844,600	(155,400)
Lothbury (Secondary, July 2018)	1,000,000	973,000	721,300	(278,700)
<b>Total change in principal</b>	5,000,000	4,684,100	4,074,500	<b>(925,500)</b>
			<b>Total dividends received to December 2023</b>	<b>1,054,800</b>
			<b>Net benefit since inception</b>	<b>129,300</b>

Table 2

### 1.3 Medium-term Investment

1.3.1 £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 £191,930 up to 29 February 2024 which represents an annualised return of 4.92%. Income is some £31,510 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 2023/24 were increased by £1,272,000 when they were revised in January 2024. The final position for the investment income for 2023/24 is expected to be a favourable variance, circa £790,000 when compared to the revised income total of £2,730,000. The increase in investment income reflects the interest rates remaining elevated for longer, and projected rates cuts now being pushed out to August/September 2024.
- 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 over time 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.

**1.7 Recommendation**

1.7.1 Members are asked to support the proposed redemption from the Lothbury Property Fund as explained at paragraphs 1.2.7 to 1.2.16.

Background papers:

contact: Donna Riley

Link Asset Services - benchmarking data.

Sharon Shelton  
Director of Finance and Transformation