TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

22 July 2024

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2023/24

The report provides an update on treasury management activity undertaken during April to May of the current financial year. The treasury management outturn position for 2023/24 is also included in this report.

1.1 Introduction

1.1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1.1.2 Following the Treasury Management training provided to Members in June 2023 the Chairman expressed an interest in externally managed funds being presented to the Committee.

1.1.3 Kelly Watson, Head of Local Government Relationships from CCLA attended Audit Committee in July 2023, presenting the LAPF Portfolio which included the fund performance and the sustainable investment outcomes.

1.2 Economic Background

1.2.1 UK April inflation data disappointed to the upside with the annual CPI inflation falling from 3.2% to 2.3%, but this was above the Bank of England and consensus view of 2.1%, with services and core inflation (excluding energy, food, alcohol and tobacco) remaining at 5.9% and 3.9% respectively.

1.2.2 However, despite these upside surprises, the CPI measure of inflation is likely to fall close to or below 2% when next reported on 19 June, and based on Capital Economics' latest forecasts is likely to fall close to 1% within the next year. Indeed, Capital Economics also forecast RPI to fall close to zero over the same timeline.

1.2.3 Nonetheless, there remain several key factors that could act as a headwind to near-term rate cuts. The first of these is the stickiness of wage inflation. Average pay is increasing at close to 6% year on year, and the BoE will be keeping a close eye on upcoming wage and employment data. In particular, it will be looking for a loosening in the labour market arising from a reduction in the near one million job vacancies, and an increase in unemployment (currently 4.3%).

1.2.4 Recent gilt market movements have been heavily influenced by the sentiment pertaining to US monetary policy. Again, inflation and labour data has proven challenging and the market's expectation for rate cuts has gradually reduced throughout the course of the year. In any event, if the BoE starts to cut rates before the US, it may mean that the medium and longer parts of the curve take longer to fully reflect any such action until the US yield curve shifts lower too. Given the potential inflationary upside risk to US treasuries depending on the outcome of the US Presidential Election in November (i.e. increased tariffs on imports from China) therein lies a further risk to yields remaining elevated for longer.

1.2.5 The upcoming General Election is not expected to have a significant impact on UK monetary policy. Both leading parties are aware of the public finance backdrop, and there is minimal leeway for further tax cuts or added spending without negatively impacting market sentiment.

1.3 Interest Rate Forecast

1.3.1 The Link Group's latest interest rate forecast below, updated following the Bank of England's Monetary Policy Committee (MPC) meeting on 9 May 2025, reflects the rates which have been kept on hold for several meetings but is now firmly in the camp of preparing the market for near-term interest rate cuts. The forecast assumes Bank Rate will see the first cut in September 2024, and a gradual reduction over the next two years to 3%.

Link - May 2024	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
	%	%	%	%	%	%	%	%	%	%	%
Bank Rate	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00
3 mth ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00
6 mth ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10
12 mth ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30
25yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30

Table 1

1.4 Investment Performance

1.4.1 In accordance with the CIPFA Code the Council's priorities, in order of importance, are to ensure security of capital; liquidity; and having satisfied both, to obtain an appropriate level of return which is consistent with the Council's risk appetite.

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

1.4.3 Cash flow surpluses are available on a temporary basis and the amount 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 a financial year and are spent by financial year end. Thus far in 2024/25 cash flow surpluses have averaged £18m per day.

1.4.4 The Authority also has £30m 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.

1.4.5 Cash flow and core cash balances also include sums to meet business rate appeals which are expected to be resolved in 2024/25 and future years.

1.4.6 Long term investments at the end of May 2024 comprised £5m in property fund investments.

1.4.7 Medium term investments at the end of May 2024 comprised £4.25m in multi-asset diversified income funds.

1.4.8 A full list of investments held on 31 May 2024 is provided at **[Annex 1]** and a copy of our lending list of 31 May is provided at **[Annex 2]**. The table below provides a summary of funds invested and interest / dividends earned at the end of May.

	Funds invested on 31 May 2024	Average duration to maturity	Weighted average rate of return	SONIA benchmark May 2024	Interest / dividends earned 1 April to 31 May 2024	Gross annualised return
	£m	Days	%	%	£	%
Cash flow	18.38	6	5.25	5.20	209,530	5.24
Core cash	30.00	128	5.57	5.16	284,800	5.59
Sub-total	**48.38**	**82**	**5.43**	--	**494,330**	**5.43**
Long term	5.00				32,400	3.89
Medium term	4.25				38,940	5.50
Total	**57.63**				**565,670**	**5.32**

Table 2

1.4.9 **Cash flow and Core cash Investments**. The SONIA one month average benchmark has remained static for several months now. In contrast, the three month average benchmark has started to shift. The downward trajectory of longer term investment rates on offer reflect market sentiment that interest rate reductions may be on the horizon. The investment portfolio will benefit from the higher rates previously secured in 2023/24, and investments will remain ahead of the investment curve for longer.

1.4.10 Interest earned of £494,304 to the end of May is £142,800 higher than the original estimate for the same period. The increase in income reflects the 5.25% bank rate which has been on hold for the sixth time in a row.

1.4.11 Bank offers are starting to pull back, reflecting the expected rate cuts now factored in for August/September of 0.25% and a further cut currently being factored into December (previously expected in Q1 of 2025). As a result, cash flow and core cash investment income will outperform the original budget. Further analysis will be carried out over the summer to refine the projections and the revised level of treasury investment income will be reported to members at a later date.

1.4.12 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. At 31 March 2024 the Council's return at 5.57% (purple diamond) was above the local authority average of 5.04%. Based on the Council's exposure to credit / duration risk that return was above Link's predicted return (between the upper and lower boundary indicated by the diagonal lines). The Council's risk exposure was also consistent with other members within the benchmarking group.

1.4.13 **Long-term Investment**. £5m of the Council's expected longer term (10 years) cash balances has been invested in three externally managed property funds. These investments provide a stable annual income to meet the Council needs and provide capital growth over time.

1.4.14 Additional property fund investments could be made in the future where resources become available from asset disposals and other windfalls. However, in the near future it is likely that we will need to redeem these investments in order to provide funds for the re-build of the Angel Leisure Centre.

1.4.15 During the period 1 April 2024 to 31 May 2024 the £5m investment in property funds generated income from dividends of £32,400 which represents an annualised return of 3.89%. The investment figure excludes Lothbury Property Trust Fund which terminated on 30 May 2024 (see 1.4.19). Please note, the last published NAV (Net Asset Value) reports was 30 April 2024. Income for the remaining two funds is in line with the budget to the end of May.

1.4.16 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.

1.4.17 Current sale value (May 2024 data (*LPT April 2024)) vs initial purchase price 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 31 May 2024 c £	31 May sale value above (below) purchase price (c-a) £
LAPF (Primary, July 2017)	1,000,000	922,200	874,700	(125,300)
Lothbury (Primary, July 2017) *****	1,000,000	927,700	717,200	(282,800)
Hermes (Secondary, Oct 2017)	1,000,000	939,000	891,000	(109,000)
LAPF (Primary, June 2018)	1,000,000	922,200	838,600	(161,400)
Lothbury (Secondary, July 2018) *****	1,000,000	973,000	703,400	(296,600)
Total change in principal	5,000,000	4,684,100	4,024,900	**(975,100)**
			Total dividends received to March 2024	**1,054,800**
Table 3			**Net benefit since inception**	**79,700**

1.4.18 Since inception, the Council has received dividends from its property fund investments totalling £1,054,800. All property fund investments recorded capital depreciation in the period April 2024 to May 2024.

1.4.19 As Members have been previously advised, Lothbury Property Trust had, for several months, been in negotiations to find a suitable merger to enable investors to continue to hold shares within the property market. Unfortunately the merger discussions did not provide the desired result and concluded with the termination of the Lothbury Property Trust on 30 May 2024.

1.4.20 The first tranche to be paid back in respect of TMBC's holdings (0.17% of the fund) represents 43.9% of the 30 April 2024 Net Asset Value (NAV). I can confirm that a receipt of £633,998.53 was received on 5 June 2024.

1.4.21 A further tranche was received on 5 July 2024 in the sum of £146,569.55. Additional funds will be distributed as and when assets are sold. The target date to complete the sales process is Q4 2024, whilst ensuring best prices are achieved. Dividends will continue to be paid on income generating assets while the fund is in the process of securing the sale of such assets.

1.4.22 Members are reminded that higher yielding investments (e.g. property, bonds, and 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 criterion. 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.

1.4.23 **Medium-term investment**. £4.25m of the Council's expected medium term cash balances together with new money derived from the sale of assets has been invested in externally managed diversified income funds. These investments will generate an annual income stream and will provide capital appreciation over time.

1.4.24 Additional multi asset fund investments could be made in the future where resources become available from asset disposals and other windfalls. However, as with the property funds, it is likely that in the near future investments will need to be redeemed in order to provide funds for the re-build of the Angel Leisure Centre.

1.4.25 During the period 1 April 2023 to 31 May 2024 the £4.25m investment in multi asset diversified income funds generated income from dividends of £38,940 which represents an annualised return of 5.50%. Income has performed some £8,360 above budget to the end of May.

1.4.26 Since inception the Council has received dividends of £492,700 from its multi-asset diversified income funds, which represents an annualised return of 4.69%.

1.4.27 As at 31 May, the value of multi asset diversified income funds stood at £3.868m compared to the initial capital investment of £4.250m. Capital values are expected to recover over the medium term.

1.5 Compliance with the Annual Investment Strategy

1.5.1 Throughout April to end of May 2024, all the requirements contained in the 2024/25 Annual Investment Strategy intended to limit the Council's exposure to investment risks (minimum sovereign and counterparty credit rating; durational limits; exposure limits in respect of counterparties, groups of related counterparty and sovereigns; and specified and non-specified investment limits) have been complied with. No borrowing was undertaken during April or May 2024.

1.5.2 The Council has also operated within the treasury limits and prudential indicators set out in the Annual Investment Strategy. The 2024/25 Prudential and Treasury Indicators will be included for review as part of the treasury management report to the September 2024 meeting of Audit Committee.

1.6 2023/24 Treasury Management Outturn

1.6.1 A detailed report covering treasury management activity for the last financial year was submitted to Cabinet on 6 July 2024 as an annex to the Revenue and Capital Outturn report for 2023/24. That annex is replicated in full and provided at **[Annex 4]** to this report. The role of this Committee is to act as scrutineer on behalf of full Council.

1.6.2 A summary of the investment performance included in Annex 4 is as follows:

	2023/24 Average balance £ m	Return %	2023/24 Interest/ dividends earned £	2023/24 Revised Estimate £	Variance Better (worse) £
Cash flow surplus	13.9	5.51	1,565,433	1,277,000	288,433
Core cash	32.0	5.39	1,641,582	1,103,000	538,582
Medium term investment	4.3	4.94	209,765	175,000	34,765
Long term investment	5.0	3.59	179,357	175,000	4,357
Total	55.2	5.28	3,596,137	2,730,000	866,137

Table 4

1.6.3 The combined performance of the Authority's investments exceeded the revised estimate by £866,137, and £1.272m when compared to the 2023/24 original estimates. The increase in investment returns is mainly due to the Bank Rate being held at 5.25% for longer than expected in 2023/24.

1.6.4 Income and expenditure attributed to the Treasury Management function for 2023/24 is provided at **[Annex 5]**. This shows the aggregate staff resource applied to treasury management remains 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 subject to changes in the level of reserves and changes in Bank Rate. Expenditure in future years is expected to rise in-line with inflation.

1.7 Legal Implications

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

1.8 Financial and Value for Money Considerations

1.8.1 Due to continuing domestic pressures including a tight labour market putting upward pressure on wages, and the continuing geo-political inflationary risks emanating from the prevailing Middle East crisis and the Russian invasion of Ukraine, Bank Rate continues to hold at 5.25%. The expectation for a 0.25% rate cut is oscillating between August and September with a further cut in December 2024.

1.8.2 Link's current forecast (updated May 2024) anticipates Bank Rate will reduce to 5.0% by September 2024 and steadily reduce to 3.0% by September 2026. The Bank Rate downward trajectory will be reflected in the market rates available to invest surplus cash, giving rise to a reduction in investment income going forward.

1.8.3 Investment income at the end of May 2024 (month two of the financial year) from cash flow surpluses and core cash investments is a favourable variance of £142,800 to the budget for the same period. Income from property funds at the end of May is in line with the budget and diversified income funds are exceeding the budget by some £8,360 for the same period. Investment income for the financial year as a whole from these sources is expected to outperform the original budget and will be reviewed at revised estimates.

1.8.4 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.

1.8.5 Whilst the annual income stream from a property fund exhibits stability (circa 3-4% 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.

1.8.6 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.

1.8.7 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 twelve 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.

1.8.8 The Lothbury Property Trust termination is expected to give rise to losses within the fund and capital investment will be distributed as and when the sales of assets take place. This could lead to a protracted winding up period of the fund to ensure best price is secured, and may not reflect the expected return based on April 2024 Net Asset Value. Dividends will continue to be paid out to shareholders while assets remain income generating.

1.8.9 Multi asset (diversified income) funds aim to limit risk by spreading investment across a broad range of asset classes (equities, bonds, property, cash). Nevertheless, the principal sum invested may fall as a consequence of adverse economic or market events. Multi asset funds are being used for medium-term investment implying but not limited to a five-year timeframe.

1.9 Risk Assessment

1.9.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered an effective way of mitigating the risks associated with treasury management.

1.9.2 Treasury Management training was provided for all Members on 19 June 2023 by Link Group. LAPF (Local Authority Property Fund) held a session for Members on 24 July 2023, providing an investment portfolio update on the fund.

1.10 Equality Impact Assessment

1.10.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act.

1.11 Recommendations

1.11.1 Members are invited to **RECOMMEND** that Council:

1) Endorse the action taken by officers in respect of treasury management activity for April to May 2024.

2) Note the 2023/24 outturn position.

Background papers: contact: Donna Riley

Link interest rate forecast (May 2024)
Link benchmarking data (March 2024)

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