**Classification:** Public
**Key Decision:** No

# Gravesham Borough Council

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| **Report to:** | Finance and Audit Committee |
| **Date:** | 16 July 2024 |
| **Reporting officer:** | Director (Corporate Services) |
| **Subject:** | Treasury Management Annual Review 2023-24 |

## Purpose and summary of report:

To report on treasury management activity during 2023-24 in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA's) revised code on Treasury Management.

## Recommendations:

1. The Finance and Audit Committee note the contents of this report.
2. Delegated authority be given to the Director (Corporate Services), in consultation with the Chair of the Finance and Audit Committee, to amend the figures in this report, as necessary following successful completion of the final accounts process.

**Key Implications:**

| Item | Implications |
|---|---|
| **Legal** | As per Section 1.13 of the Council's Constitution, the Chief Finance Officer has delegated responsibility from Cabinet.<br><br>"in respect of borrowing and investments to arrange such loans as are legally permitted to meet the Council's borrowing requirements" |
| **Finance and Value for Money** | A summary of the perceived risks associated with Treasury Management were identified in the Treasury Management Strategy approved by Council on 21 February 2023. Officers continue to monitor the risks on a day to day basis and identfiy mitigating action to minimise risks.<br><br>In order to achieve a balanced budget, the authority relies upon generating maximum interest from its investments whilst minimising the exposure to risk. In order to achieve this, investments are only placed with institutions which meet the criteria set out within this report. Investment durations do no exceed those as advised by Link Asset Services credit ratings which are associated with the specific institutions.<br><br>Where the authority is required to borrow to meet the needs of the authority, Officers will seek advice from Link Asset Services on timings and options in order to ensure the best deal for the authority. |

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| **Corporate Plan** | ***One Council***: a well-run and innovative authority, defined by its skilled and valued workforce, committed to developing its local social impact.<br><br>**Financial responsibility**: a financially sustainable authority, driven by a strong Medium Term Financial Strategy, enforced by a suite of effective financial monitoring controls.<br><br>**Corporate compliance**: a responsible organisation, ensuring all constitutional, policy and legislative demands are met, and pro-active risk management practices adopted. |
| **Climate Change** | N/A |

## 1. INTRODUCTION

1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2023-24. 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).

1.2 In accordance with reporting requirements for each financial year, Full Council received the following reports for 2023-24:

- an annual treasury strategy in advance of the year (Council 21 February 2023)
- a mid-year (minimum) treasury update report (Council 5 December 2023)
- an annual review following the end of the year describing the activity compared to the strategy (this report, which will be received by Council on 15 October 2024 through consideration of the Minutes of this meeting of the Finance & Audit Committee)

1.3 The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

1.4 The report also provides confirmation that the Council has complied with the requirement, under the Code, to give prior scrutiny to all of the above treasury management reports by the Finance and Audit Committee before they were reported to the Full Council. Member training on treasury management issues was undertaken during the year on 29 June 2023 in order to support members' scrutiny role.

1.5 As previously reported to Finance and Audit Committee, the external audit process of reviewing and certifying the 2019/20 Statement of Accounts was significantly delayed. The audit has now completed but the preparation and audit process for subsequent Statement of Accounts up to and including 2023/24 have yet to be concluded. For this reason, delegated authority is sought for the Director (Corporate Services) to amend the figures stated in this report, following successful completion of the final accounts process, in consultation with the Chair of the Finance and Audit Committee.

1.6 Previous year comparisons within the report have, in some cases, been updated where the completion of the 2019/20 Statement of Accounts has had an impact on various prudential and treasury indicators.

## 2. THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING

2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

2.1.1 Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

2.1.2 If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

| | 2022/23 Actual £m | 2023/24 Revised Budget £m*[1] | 2023/24 Actual £m*[2] |
|---|---|---|---|
| Capital Expenditure – Non HRA | 29.759 | 29.670 | 10.153 |
| Capital Expenditure – HRA | 13.842 | 23.106 | 14.772 |
| Total Capital Expenditure | 43.601 | 52.776 | 24.925 |
| Financed in Year | 4.215 | 29.200 | 16.672 |
| Unfinanced Capital Expenditure | 39.386 | 23.576 | 8.253 |

*[1] as per TMSS 2024/25

*[2] based on the Provisional Outturn Report 2023/24

## 3. THE COUNCIL'S OVERALL BORROWING NEED

3.1 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2023/24 unfinanced capital expenditure and prior years net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, officers organise the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

3.3 **Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need, (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

3.4 The total CFR can also be reduced by

3.4.1 the application of additional capital financing resources, (such as unapplied capital receipts); or

3.4.2 charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.5 The Council's 2023/24 MRP Policy, (as required by DLUHC Guidance), was approved as part of the Treasury Management Strategy Report for 2023/24 on 21 February 2023

3.6 The Council's CFR for the year is shown below and represents a key prudential indicator.

| | 31 March 2023 Actual £m | 31 March 2024 Revised Budget £m*[1] | 31 March 2024 Actual £m*[2] |
|---|---|---|---|
| CFR Non HRA (£m) | 79.283 | 97.467 | 84.979 |
| CFR HRA (£m) | 84.169 | 84.614 | 79.000 |
| Total CFR | 163.452 | 182.081 | 163.979 |
| Gross Borrowing Position | 151.983 | 190.412 | 152.473 |
| Over / (under) funding of CFR | (11.469) | 8.331 | (11.506) |

*[1] as per TMSS 2024/25

*[2] based on the Provisional Outturn Report 2023/24

3.7 **Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2023/24) plus the estimates of any additional capital financing requirement for the current (2024/25) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. The table below highlights the Council's gross borrowing position (external debt plus finance lease) against the CFR. The Council has complied with this prudential indicator.

3.8 TMSS Mid-Year Review 23-24, indicated that by the end of the year gross debt would exceed the Council's CFR primarily due to the St Georges transaction. However, by carefully utilising the Council's cash balances to minimise the increase in new external debt, this has been avoided and the Council's under borrowed position has increased further from the previous year. Further details in Para 4.3.

3.9 **The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2023/24 the Council has maintained gross borrowing within its authorised limit.

3.10 **The operational boundary –** the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.11 **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

| | 2023/24 £m |
|---|---|
| Authorised Limit (as per TMSS 2023/24) | 405.770 |
| Maximum gross boundary position during the year | 169.643 |
| Operational boundary (as per TMSS 2023/24) | 390.770 |
| Average gross borrowing position | 147.143 |
| Financing costs as a proportion of net revenue stream (Non Housing) | 13.42% |
| Financing costs as a proportion of net revenue stream (HRA) | 30.15% |

3.12 The financing cost as a proportion of net revenue stream for Non-Housing is calculated by taking the net of interest payable in respect to borrowing, interest receivable on investments and the annual debt repayment as a percentage of income (defined as income received in relation to the Council's share of Business Rates, Council Tax and rental income from investment properties).

3.13 The financing cost as a proportion of net revenue stream for Housing is calculated by taking the net of interest payable in respect to borrowing, interest receivable on investments and the annual Minimum Revenue Payment (MRP) as a percentage of rental income received in relation HRA dwellings.

3.14 Due to the way this ratio is calculated, higher debt repayment or voluntary increases in the Council's MRP can result in a increase in the financing cost ratio. Therefore, comparisons to previous years should be viewed with some caution. The most important consideration for both the General Fund and the HRA to ensure that any new debt is affordable both in the long and short term.

## 4. TREASURY POSITION AS AT 31 MARCH 2024

4.1 The Council's treasury position at the beginning and the end of 2023-24 was as follows:

4.2 The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2023/24 the Council's treasury position, was as follows:-

| | 31 March 2023 Principal £m | Rate | 31 March 2024 Principal £m | Rate |
|---|---|---|---|---|
| PWLB Loans | 60.718 | 2.964% | 105.073 | 4.188% |
| Market Loans | 33.200 | 0.582% | 27.400 | 0.687% |
| Temporary Loans | 32.300 | 2.483% | 20.000 | 3.508% |
| Trust Funds[1] | 0.014 | Variable | 0.017 | Variable |
| St George's Loan | 25.751 | 8.32% | 0.000 | 0.000% |
| **Total Debt** | **151.983** | | **152.490** | |
| Capital Financing Requirement (CFR) | 163.452 | | 163.979 | |
| Over/ (Under) borrowing | (11.469) | | (11.489) | |
| **Total Investments** | **40.282** | | **18.594** | |
| Net Debt (Total Debt minus Total Investments) | 111.701 | | 133.896 | |

Note [1] –The Council pays interest on Trust Fund balances held at 50 basis points below the Bank of England Base Rate

4.3 The Mid-Year Treasury Management Strategy Update 2023-24 and the Annual Treasury Strategy Statement 2024-25 detailed the assumption that the level of debt would exceed the Council's CFR position. This was due to the refinancing of the St George's Centre arrangements and the borrowing requirements which underpinned the Council's capital programme in 2023/24. The capital programme for both the General Fund and HRA did not proceed as originally intended meaning both the external financing requirement and the use of reserve balances and capital receipts reduced. This enabled the Council to utilise cash balances in the short term as opposed to taking on additional debt which was much more cost effective given the current prevailing interest rate and has enabled the Council to protect its under borrowed position.

4.4 The Council's cash flow position for the coming and future years will be reviewed in due course, in order to update future CFR projections.

4.5 From 2018/19, this authority has operated a two loans pool, split between the General Fund and Housing Revenue Account (HRA).

4.6 The maturity structure of the debt portfolio was as follows:

| | 31 March 2023 Actual £m | March 2023 Actual % | 2023/24 Original limits | 31 March 2024 Actual £m | March 2024 Actual % |
|---|---|---|---|---|---|
| Under 12 months | 46,484 | 30.58 | 50% | 51.753 | 33.94 |
| 12 to 24 months | 30,410 | 20.01 | 50% | 11.009 | 7.22 |
| 24 months to 5 years | 38,174 | 25.12 | 75% | 43.634 | 28.61 |
| 5 to 10 years | 11,164 | 7.35 | 75% | 6.631 | 4.35 |
| More than 10 years | 25,751 | 16.94 | 100% | 39.463 | 25.88 |

| Investment Portfolio | Actual 31 March 2023 £m | Actual 31 March 2023 % | Actual 31 March 2024 £m | Actual 31 March 2024 % |
|---|---|---|---|---|
| **Treasury Investments** | | | | |
| Fixed Term Investments | 2.000 | 4.97 | 0.000 | 0.00 |
| Certificate of Deposits | 17.861 | 44.34 | 0.000 | 0.00 |
| Notice Accounts | 0.000 | 0.00 | 0.000 | 0.00 |
| Money Market Funds | 2.564 | 6.36 | 1.480 | 7.83 |
| **Total managed in house** | **22.425** | **55.67** | **1.480** | **7.83** |
| Property Funds | 9.343 | 23.20 | 8.540 | 45.20 |
| Multi Asset Funds | 8.513 | 21.13 | 8.874 | 46.97 |
| **Total managed externally** | **17.856** | **44.33** | **17.414** | **92.17** |
| **Total Treasury Investments** | **40.282** | **100.00** | **18.894** | **100.00** |

4.7 All internally managed investments were for up to one year.

4.8 The level of internally managed investments held as at 31 March 2024 have decreased from the previous year. This is as a direct consequence of the actions identified in Para 4.3 where the Council has actively used it cash balances as opposed to taking on external debt at the current elevated levels.

## 5. THE INVESTMENT STRATEGY AND CONTROL OF INTEREST RATE RISK FOR 2023/24

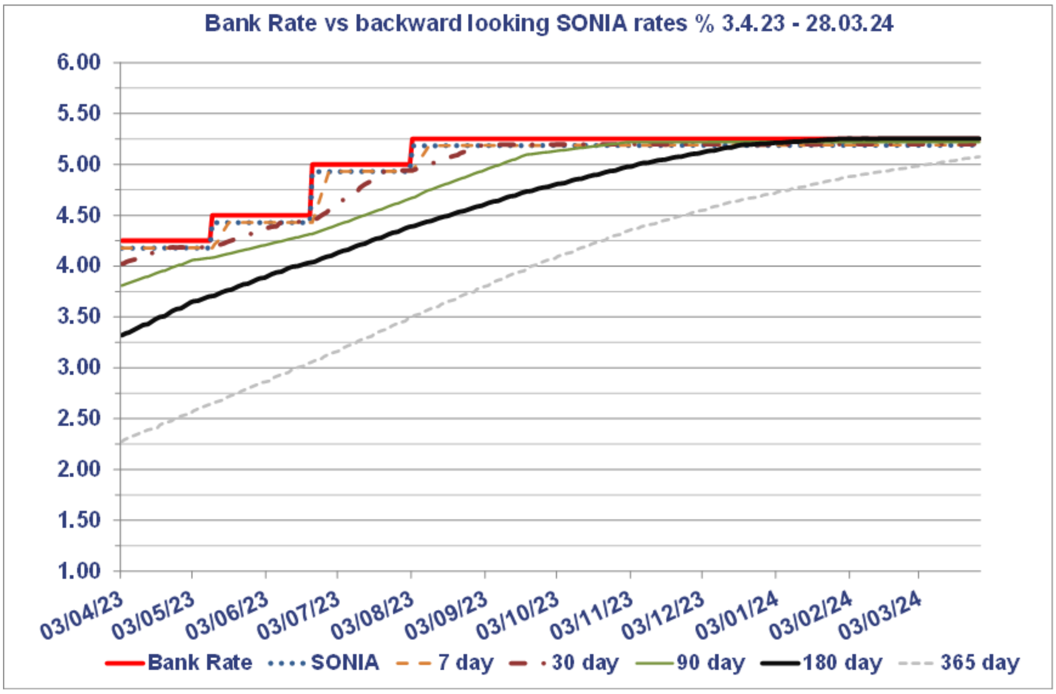
5.1 Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, continued to respond to inflationary pressures that were not transitory, and realised that tighter monetary policy was called for.

5.2 Starting April at 4.25%, Bank Rate moved up in stepped increases of either 0.25% or 0.5%, reaching 5.25% by August. By the end of the financial year, no further increases were anticipated. Indeed, the market is pricing in a first cut in Bank Rate in either June or August 2024.

5.3 The upward sloping yield curve that prevailed throughout 2023/24 meant that local authorities continued to be faced with the challenge of proactive investment of surplus cash, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape.

5.4 With bond markets selling off, UK equity market valuations struggled to make progress, as did property funds, although there have been some spirited, if temporary, market rallies from time to time – including in November and December 2023. However, the more traditional investment options, such as specified investments (simple to understand, and less than a year in duration), have continued to be at the forefront of most local authority investment strategies, particularly given Money Market Funds have also provided decent returns in close proximity to Bank Rate for liquidity purposes. In the latter part of 2023/24, the local authority to local authority market lacked any meaningful measure of depth, forcing short-term investment rates above 7% in the last week of March.

5.5 While the Council has taken a prudent approach to investing surplus monies, 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 Global Financial Crisis of 2008/09. 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 stressed market and economic conditions.



## 6. BORROWING STRATEGY AND CONTROL OF INTEREST RATE RISK RATES IN 2023/24

6.1 During 2023/24, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2024 and 2025 as inflation concerns are dampened. The Council has sought to minimise the taking on of long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years) as appropriate.

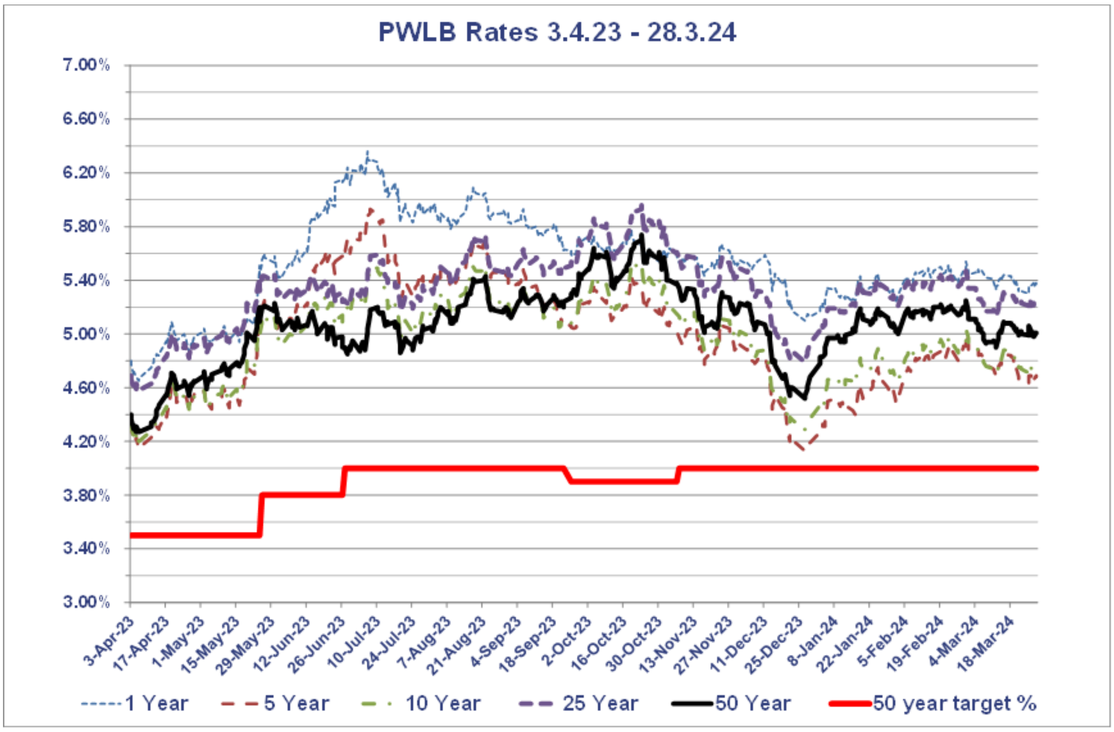
6.2 Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director (Corporate Services) therefore monitored interest rates in financial markets and adopted a pragmatic strategy.

6.3 Long term borrowings were postponed, short term borrowing was considered when rescheduling from fixed rate with cash balances being used in the first instance. New short term debt only taken when necessary and cost effective.

6.4 Interest rate forecasts initially suggested further gradual rises in short, medium and longer-term fixed borrowing rates during 2023/24. Bank Rate had initially been forecast to peak at 4.5% but it is now expected to have peaked at 5.25%.

6.5 By January it had become clear that inflation was moving down significantly from its 40-year double-digit highs, and the Bank of England signalled in March 2024 that the next move in Bank Rate would be down, so long as upcoming inflation and employment data underpinned that view. Currently the CPI measure of inflation stands at 3.4% but is expected to fall materially below 2% over the summer months and to stay there in 2025 and 2026. Nonetheless, there remains significant risks to that central forecast, mainly in the form of a very tight labour market putting upward pressure on wages, and continuing geo-political inflationary risks emanating from the prevailing Middle East crisis and the Russian invasion of Ukraine

| Link Group Interest Rate View | 08.11.22 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 |
| BANK RATE | 3.50 | 4.25 | 4.50 | 4.50 | 4.50 | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 | 2.75 | 2.50 | 2.50 |
| 3 month ave earnings | 3.60 | 4.30 | 4.50 | 4.50 | 4.50 | 4.00 | 3.80 | 3.30 | 3.00 | 3.00 | 2.80 | 2.50 | 2.50 |
| 6 month ave earnings | 4.20 | 4.50 | 4.60 | 4.50 | 4.20 | 4.10 | 3.90 | 3.40 | 3.10 | 3.00 | 2.90 | 2.60 | 2.60 |
| 12 month ave earnings | 4.70 | 4.70 | 4.70 | 4.50 | 4.30 | 4.20 | 4.00 | 3.50 | 3.20 | 3.10 | 3.00 | 2.70 | 2.70 |
| 5 yr PWLB | 4.30 | 4.30 | 4.20 | 4.10 | 4.00 | 3.90 | 3.80 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 | 3.10 |
| 10 yr PWLB | 4.50 | 4.50 | 4.40 | 4.30 | 4.20 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 |
| 25 yr PWLB | 4.70 | 4.70 | 4.60 | 4.50 | 4.40 | 4.30 | 4.10 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.50 |
| 50 yr PWLB | 4.30 | 4.40 | 4.30 | 4.20 | 4.10 | 4.00 | 3.80 | 3.70 | 3.60 | 3.40 | 3.30 | 3.20 | 3.20 |




6.1 PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

6.2 However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid; then because of the inflationary impact of the war in Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the FOMC, ECB and Bank of England are all being challenged by levels of persistent inflation that are exacerbated by very tight labour markets and high wage increases relative to what central banks believe to be sustainable.

6.3 Gilt yields have been on a continual rise since the start of 2021, peaking in the autumn of 2023. Currently, yields are broadly between 3.5% and 4.25%.

6.4 At the close of the day on 28 March 2024, all gilt yields from 1 to 50 years were between 3.81% and 4.56%, with the 1 year being the highest and 6-7 years being the lowest yield. Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:-

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **HRA Borrowing Rate** is gilt plus 40bps (G+40bps)

6.5 There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate falls and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

6.6 As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

6.7 The Bank of England is also embarking on a process of Quantitative Tightening, the Bank's original £895bn stock of gilt and corporate bonds will gradually be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is market pricing of gilts, while issuance is markedly increasing, and high in historic terms, is an unknown at the time of writing.

## 7. BORROWING OUTTURN FOR 2023/24

7.1 Loans were drawn to partially fund the net unfinanced capital expenditure and naturally maturing debt. The loans drawn were

| Lender | Fund | Principal | Type | Average Rate | Maturity |
|---|---|---|---|---|---|
| PWLB | HRA | £11,300,000 | EIP | 4.190% | 13 years |
| PWLB | GF | £41,425,000 | EIP & Fixed Interest Rate | 5.682% | 25-45 years |
| Market | GF | £20,000,000 | Fixed Interest Rate | 5.07% | 2 months – 1 year |

7.2 The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.

7.3 No rescheduling of debts was carried out during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7.4 On 28 March 2024, a further loan the Council had taken on because of HRA self-financing matured. Loan principal totalling £8.370m was repaid. The Council has made a voluntary contribution of Minimum Revenue Provision (MRP) of £6.798m to reduce the CFR accordingly, the HRA refinanced the balance of £1.572m.

## 8. INVESTMENT OUTTURN FOR 2023/24

8.1 **Investment Policy** - the Council's investment policy is governed by Department for Levelling Up Homes and Communities & Local Government (DLUHC) investment guidance, which has been implemented in the annual investment strategy approved by the Council on 21 February 2023. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

8.2 The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

8.3 **Investments held by the Council** – the Council maintained an average balance of £28.186m of internally managed funds during the year with a weighted average maturity of 30.83 days. The internally managed funds earned an average rate of return of 4.93%. Therefore the 30-day backward SONIA (sterling overnight index average) uncompounded rate Is the best benchmark to use as a comparison which for 2023/24 was 4.93%. Therefore, the internally managed funds return was equally comparable to this benchmark.

8.4 **Externally Managed Funds** – The Council has investments in Property and Multi Asset Funds. These deposits are managed by external fund managers and the Council receives dividend returns on the investments. The dividends received have been consistent during the investment period and significantly higher than would have been achieved from more traditional investments during the recent period of historically low interest rates. However, with the Bank of England Base Rate steadily increasing, similar or in some cases better returns can be achieved from more traditional fixed rate return investments.

8.5 These are long term investments as the capital values can fluctuate due to a number of factors with values going up as well as down and past performance is not a guarantee of future return. At present the Council is only required to reflect any capital loss or gain on the investment at the point of redemption.

8.5.1 **Property Funds** – As at 31 March 2024 the Property Fund Net Asset Value (NAV) and Annual Return on Investment was as follows:

| Property Funds | 31 March 2023 NAV £ | 31 March 2023 ROI*1 % | 31 March 2024 NAV £ | 31 March 2024 Estimated ROI*1 % |
|---|---|---|---|---|
| Lothbury | 4,424,752 | (7.66) | 3,889,784 | (18.34) |
| Hermes | 3,089,175 | 10.91 | 2,892,490 | 4.11 |
| CCLA | 1,829,298 | (2.32) | 1,757,908 | (6.12) |
| Total | 9,343,225 | (15.84) | 8,540,182 | (1.26) |

*1 annual return on investment (based on movement in capital value from previous year and dividend income received in year)

8.5.2 After an initial spike in June 2022, when the three property funds had a combined Net Asset Value (NAV) of £12m, which is the highest combined value since the investment commenced, the capital values of all three property funds have continued to fall during the course of 2023/24 as the property market corrects itself in a post Covid environment and in response to the current economic conditions. Despite the decline in capital values, the funds have provided a steady dividend return for the Council since the initial deposit in 2016 albeit the funds are returning an overall negative Return on Investment (ROI) due to the large fall in capital values.

8.5.3 Hermes is the only property fund that is giving a small positive return on investment. This is being driven by the fact that there was a small capital growth in the value of investment (from the initial investment) of 0.30%.

8.5.4 Appendix 2 to this report shows how the capital fund valuations have changed month on month since 2016.

8.5.5 We have met with all Property Fund Managers on a regular basis during the year to ensure that we are fully aware of the latest fund developments and future plans.

8.5.6 **Lothbury Property Fund** – In June 2023, the Lothbury Property Fund received a significant level of redemption requests which made the future of the fund uncertain. Following discussions with Lothbury, the Council's Treasury Management Consultants, Link, the Council also submitted a redemption request. In the following weeks, various meetings were held with Lothbury investors to help determine and shape the future of the fund. An update was provided to the Finance and Audit Committee as part of the Mid-Year Treasury Management Strategy Update.

8.5.7 A possible merger with the UBS managed fund Triton was considered and put forward as a solution to those investors not wishing to completely disinvest from the Property fund asset class. The initial proposal was rejected at an EGM which meant the fund would terminate on 31 March 2024. However, a subsequent proposal was put forward which sought an extension to the termination date from 31 March 2024 by a maximum of 60 days to enable assets equal to the value of holdings of the investors wishing to move to the Triton fund to be transferred from Lothbury. Whilst the management of the Council's investments are within the Director (Corporate Services) delegated authority a report was presented to Cabinet on 18 March which endorsed the decision to support the proposal to extend the termination date and for the Council's investment to be transferred to the UBS managed Triton Fund. The same report was also considered by the Overview and Scrutiny Committee.

8.5.8 Sufficient support was secured at the second EGM and therefore the termination date was postponed and it initially appeared that the Council would be able to transfer its investment from the Lothbury Property Fund to the UBS managed Triton Fund. However, an urgent investor meeting was called on 10 May where investors were provided with an update on the progress made towards transferring assets to UBS (that were an equivalent value to the investors wishing to transfer). Surveys of five Purpose Built Student Accommodation assets known as PBSA, which had a value of £126m equal to approximately to 14.8% of the Net Asset Value (NAV) had revealed that, whilst the buildings were considered safe, further risk assessments were necessary. These surveys were carried out immediately and the findings indicated that approximately £21.5m of work was needed to bring the building up to meet current Building Safety Regulations. As a result, the fund valuers, CBRE, applied a material valuation uncertainty clause to the fund valuation as at end April 2024. Consequently, UBS expressed concern about how the costs and subsequent valuations had been determined and therefore it was no longer possible for those investors wishing to transfer their full investment from Lothbury to the UBS managed Triton Fund.

8.5.9 As a result, the Lothbury Property Fund terminated on 31 May. All investors will be treated equally and will receive cash distributions monthly as and when assets are sold. The Council will need to account for the capital loss on its investment as and when each distribution is made. The total capital loss will not be known until all assets sold and cash distributions made.

8.5.10 Lothbury are continuing to deal with the issues relating to the PBSA assets and have commissioned further reports which will inform the scope of works required. Works will be tendered and once prices have been received Lothbury will consider next steps.

8.5.11 **Multi-Asset Funds** – As of 31 March 2024 the value of the Council's investment in the Multi Asset Funds and Annual Return on Investment was as follows:

| Multi Asset Funds | 31 March 2023 £ | 31 March 2023 ROI*1 % | 31 March 2024 £ | 31 March 2024 Estimated ROI*1 % |
|---|---|---|---|---|
| JP Morgan | 4,394,330 | (12.07) | 4,523,196 | (9.50) |
| Jupiter | 2,420,370 | (19.30) | 2,602,938 | (13.22) |
| Aberdeen | 1,698,416 | (15.04) | 1,747,359 | (13.17) |
| Total | 8,513,116 | (11.44) | 8,873,493 | (8.21) |

*1 annual return on investment (based on movement in capital value from previous year and dividend income received in year)

8.5.12 The capital values of the Multi Asset Funds during the year have continued to be volatile against the current economic background but ended the year up on the previous year's valuation.

8.5.13 As with Property Funds, the Multi Asset Funds have continued to provide the Council with a dividend return, consistent with previous years, but whilst the overall Return on Investment (ROI) is negative for all funds due to the reduction in the capital values, it has improved on last year.

8.5.14 Appendix 3 to this report shows how the capital fund valuations have changed month on month since 2018.

8.5.15 As with the Property Funds, Officers have closely monitored the capital values and have been in regular contact with Fund Managers, to ensure they are aware of the latest developments and future plans.

## 9. BACKGROUND PAPERS

There are no background papers to this report.

## 10. Appendices

10.1 The following documents are to be published with the report:

10.2 Appendix 1 – Prudential and Treasury Indicators Summary

10.3 Appendix 2 – Property Fund Summary

10.4 Appendix 3 – Multi Asset Fund Summary

## 11. Background Documents

11.1 There following background documents were used:

11.2 Treasury Management Strategy Statement 2023-24: F&A 13 February 24 agenda item 4

11.3 Treasury Management Mid-Year Review 2023-24: F&A 8 November 24 agenda item 7)

11.4 Future of the Lothbury Property Fund: Cabinet 18 March 24 agenda item 13

11.5 Future of the Lothbury Property Fund: Cabinet 18 March 24 minutes item 97

11.6 Future of the Lothbury Property Fund: Overview & Scrutiny Committee 25 March 24 minutes item 36

11.7 Interest in land and assets belonging to the Council: Cabinet 11 September 24 agenda item 11

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| Secondary Implications | |
|---|---|
| **Risk Assessment** | The risks associated with Treasury Management and capital expenditure are detailed within this report |
| **Data Protection Impact Assessment** | *A data protection impact assessment (DPIA) should be carried out at the start of any major project involving the use of personal data or if you are making a significant change to an existing process.* |
| | a. Does the project/change being recommended through this paper involve the processing of personal data or special category data or criminal offence data?<br>A definition of each type of data can be found on the Information Commissioner's Office website via the above links.<br>No |
| | b. If yes to question a, have you completed and attached a DPIA including Data Protection Officer advice?<br>N/A |
| | c. If no to question b, please seek advice from your nominated DPIA assessor or the Information Governance Team at gdpr@medway.gov.uk.<br>N/A |
| **Equality Impact Assessment** | a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer.<br>No |
| | b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer.<br>N/A |
| | *In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above* |
| **Crime and Disorder** | Treasury Management activities are carried out in accordance with the Treasury Management Strategy and Annual Investment strategy which minimises the risk of criminal activities. The arrangements to ensure appropriate governance around capital expenditure are set out in the Capital Strategy. |
| **Digital and website implications** | N/A |
| **Safeguarding children and vulnerable adults** | N/A |