LINK Group

Tandridge District Council

Review of Treasury Management Activity

September 2021

Introduction

The Council wishes to review its Treasury Management activity in a holistic approach to see if the current approach which has been adopted is still appropriate going forward. The analysis also included the review of the current external fund managers, if they are still appropriate and meet the requirement of the Council and if the level of balance invested in longer term still viable.

Balance Sheet Position

When advising the Council on borrowing and on investment strategy, the first starting point is the balance sheet position, this helps to identify the level of cash balances and borrowing requirements.

We have undertaken the balance sheet review for the Council for 2020/21, which is included in Appendix 1 in its entirety, however, the tables below show the breakdown of the balance sheet.

Capital Financing Requirement & Borrowing:

Summary Balance Sheet Review	2018-19 £000	2019-20 £000	2020-21 £000
Capital Financing Requirement	74,087	107,121	108,369
less: External Borrowing	87,288	104,615	100,365
Under /(Over) Borrowing	(13,201)	2,506	8,004
Reserves / Balances available for investment	19,444	20,088	22,999
less: external Investments	35,385	22,244	24,228
Surplus Monies	(15,941)	(2,156)	(1,229)
Working Capital Surplus	**2,740**	**4,662**	**9,233**

Based on the balance sheet it shows that the Council had a Capital Financing Requirement (CFR, this is the underlying need to borrow for capital purposes i.e. capital expenditure net of all capital receipts, grant, revenue contributions to capital outlay etc.) of £108m as at 31st March 2021, which was an increase of £1.2m from the previous year. The Council had external borrowing of £100m, which meant £8.4m was financed through internal borrowing.

Reserves and Balances and Investments

Reserves & Balances	2018-19 £000	2019-20 £000	2020-21 £000
General Fund Balance	2,326	2,242	2,243
Housing Revenue Account Balance	750	750	2,796
Collection Fund Adjustment Account	(322)	(75)	(6,656)
Earmarked reserves/other balances	9,340	7,462	12,772
Capital Receipts Reserve	3,569	2,961	3,380
Provisions (exe. Accumulating absences)	456	1,121	2,001
Capital Grants Unapplied	3,325	5,627	6,463
Amount Available for Investment	**19,444**	**20,088**	**22,999**

Investments	2018-19 £000	2019-20 £000	2020-21 £000
Short - Term	11,734	10,903	14,592
Long - Term	6,306	5,992	6,114
Cash & Cash Equivalents	17,345	5,349	3,522
Total Investment	**35,385**	**22,244**	**24,228**

The Council had £23m of reserves and balances and £9.2m of working capital, less the £8.4m of internal borrowing, meant that at year end the Council had external investment position of £24m.

Summary Balance Sheet Position – 31st March 2021

The investment position on the Balance Sheet can be explained in summary through the following table:

	2018-19 £000	2019-20 £000	2020-21 £000
Reserves & Balances	19,444	20,088	22,999
Under / (Over) Borrowing	(13,201)	2,506	8,004
Working Capital Surplus	2,740	4,662	9,233
Total Investment	**35,385**	**22,244**	**24,228**

Current Debt and Investment Position

Debt Portfolio

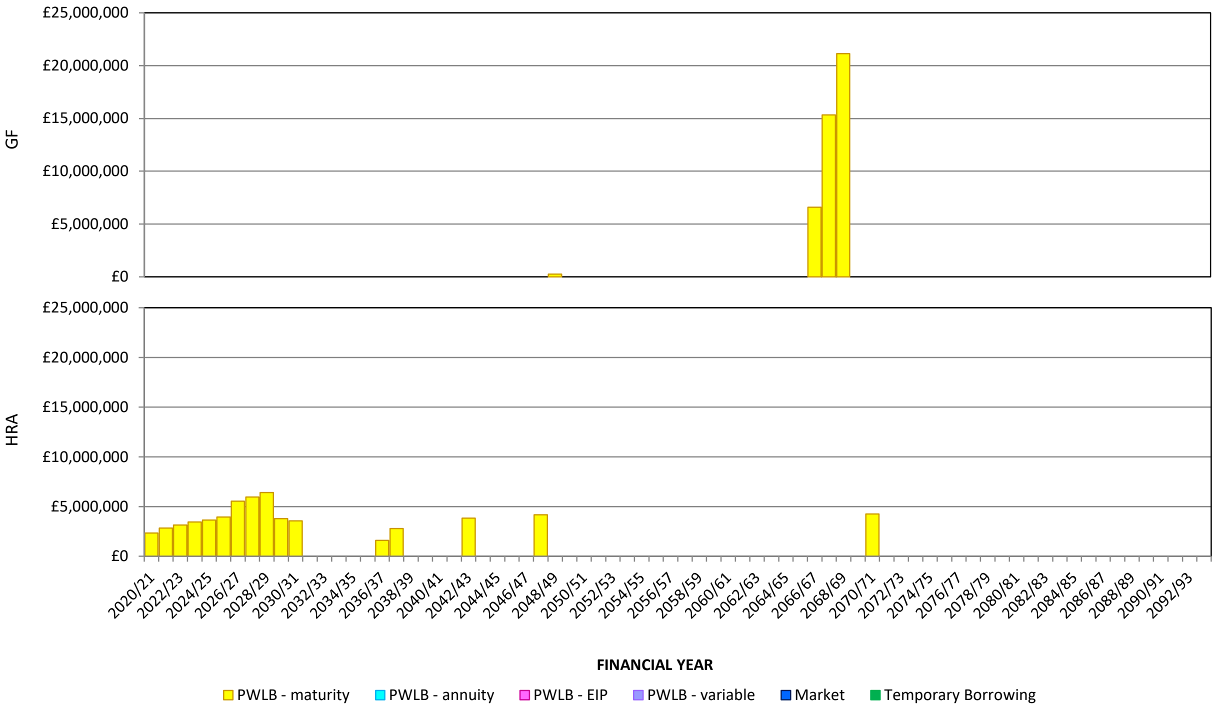
The current debt portfolio of the Council is £104.615m of Public Works Loan Board (PWLB) loans of which £61m is Housing Revenue Account (HRA) debt. It operates a two pool approach.

The HRA portfolio has an average rate of 2.785% and an average life of 12.38years. The portfolio has loans maturing each year, which will be refinanced in accordance with the HRA business plan.

The General Fund (GF) portfolio has an average rate of 2.49% and an average life of 47.55years.

The Council had budgeted borrowing cost at 2.5% for 2020/21. The £8m of internal borrowing as at 31st March 2021 meant that the Council generated a net borrowing cost saving of £192k (assuming loss of investment income at 0.10%)

Current Maturity Profile



The Council has now replaced the £4.250m HRA loan which matured in March 2021 with a 50 year PWLB loan at an interest rate of 1.91% which is 30bps cheaper than the previous loan, therefore generating interest cost saving of £12,750 per annum.

Investment Portfolio

The current investment portfolio of the Council as at the end of June 2021 was £25.988m, of which £12m (original principal) is invested with external fund managers and the remaining is managed in-house.

The £12m which is managed externally has been split in the following managers:

- CCLA Property Fund - £4m
- Schroders Credit Fund - £3m
- CCLA Diversified Income Fund - £2m
- UBS Multi-Asset Income Fund - £3m

This element of the portfolio is the long term focussed, with the Property Fund having the longest investment time horizon of 5-10 years+, multi-asset funds typically 5yrs+ and the Council's bond fund

3-5yrs. When decision was taken to invest in these funds, the Council had identified this element of cash as core which could be invested over a longer time horizon.

Based on the balance sheet review as at the 31st March 2021, which shows the Council has £24m of external investment, this confirms that Council still has scope to maintain this level of cash invested in longer term focussed investments.

Returns on these funds are driven by two elements, income and movements in underlying capital values. Whilst the capital value is based on the unrealised gains/losses of the fund, which under IFRS9 would have a direct impact on the GF reserves, the CIPFA override currently removes this risk. The CIPFA override was put in place for 5 years, due to expire in 2022/23 unless it is extended.

The following table outlines the investment income that the Council has received in the last five years from its funds. The columns show the actual income received from each fund for each financial year and then the yield, which is calculated by dividing the income amount by the capital value of each fund at year-end.

Gross Revenue Yield	2016/17		2017/18		2018/19		2019/20		2020/21	
	Income	Yield	Income	Yield	Income	Yield	Income	Yield	Income	Yield
	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	164,434	4.03%	193,758	4.53%	183,989	4.30%	185,240	4.42%	179,910	4.33%
Schroders Bond Fund	127,340	4.30%	105,413	3.62%	120,508	4.21%	124,418	4.90%	125,529	4.32%
UBS Multi Asset Fund	100,600	3.33%	146,788	5.03%	116,513	4.06%	137,531	5.46%	140,171	5.05%
CCLA Diversification Fund	n/a	n/a	62,732	3.27%	67,030	3.38%	66,284	3.67%	62,069	3.17%
Total	**392,375**		**508,691**		**488,040**		**513,473**		**507,679**	

Year-end capital values for each of the funds are provided in the table below:

Market Value	2016/17	2017/18	2018/19	2019/20	2020/21
	31.3.2017	31.3.2018	31.3.2019	31.03.2020	31.03.2021
	£	£	£	£	£
CCLA Property Fund (mid-market value)	4,082,986	4,276,854	4,276,005	4,188,063	4,158,183
Schroders Bond Fund	2,963,563	2,912,837	2,865,130	2,539,938	2,908,911
UBS Multi Asset Fund	3,018,705	2,918,160	2,868,479	2,520,713	2,777,398
CCLA Diversification Fund (indicative market value)	n/a	1,921,257	1,982,167	1,804,193	1,955,874
Total	**10,065,254**	**12,029,108**	**11,991,781**	**11,052,907**	**11,800,366**

As at 30th June 2021 the Council had £13.257m managed in-house. The portfolio was managed using a combination of Money Market Funds (MMFs) and Ultra-Short-Dated Bond Funds (USDBFs). This provides the Council with a high level of liquidity while the underlying short-term nature of the investments within these funds is reflected in their low yields.

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
MMF Aberdeen Standard Investments	5,000	0.01%		MMF	AAAm	
MMF CCLA	4,000,000	0.03%		MMF	AAAm	
MMF Goldman Sachs	5,000	0.00%		MMF	AAAm	
MMF Invesco	1,205,000	0.01%		MMF	AAAm	
MMF Morgan Stanley	4,000,000	0.03%		MMF	AAAm	
USDBF Federated Sterling Cash Plus Fund	2,040,381	0.11%		USDBF	AAAf	
USDBF Insight Liquidity Plus	2,001,464	0.01%		USDBF	AAAf	
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**		
CCLA Property Fund	4,000,000					
CCLA Diversified Income Fund Class 2 Units - Income	2,000,000					
UBS Multi Asset Income Fund (Class L Shares Inc)	3,000,000					
Schroder Strategic Credit L Income Fund	3,000,000					
Funding Circle	731,156					
Total Investments	**£25,988,000**					
Total Investments - excluding Funds	**£13,256,844**	**0.04%**				-
Total Investments - Funds Only	**£12,731,156**					

The investment balance is higher than usual due to the high Government support provided as a result of the Pandemic.

Fund Manager Selection Process

Following the decision to unwind the £2m invested in the Funding Circle, the Council wanted to look at options available for longer term investment. The Council employed Link to support it in undertaking a fund manager selection process. The focus of this was on the multi-asset fund class, where the Council already had previous experience of their use and given that they aim to provide investors relatively high levels of income within overall returns in addition to liquidity and a strong level of underlying diversification. As outlined above, the Council already uses two such funds, CCLA Diversified Income Fund and the UBS Multi-Asset Income Fund.

The Council had first invested in the UBS fund in October 2015 and added to this initial position in September 2016. For the CCLA fund, the Council made one investment in April 2017. Given the length of time since these investments had been made, the Council decided it would be opportune to review a wider range of potential fund options, to ensure that it made the most appropriate decision on where to invest going forward, including whether its existing managers were still fit for purpose.

A total of seventeen suitable managers were asked to complete a detailed questionnaire on their proposed multi-asset fund. Of these, four managers declined to participate, including UBS, who cited a lack of available personnel due to summer holiday commitments to be able to complete the questionnaire in a suitable and timely manner.

From the eventual long list of funds, the Council chose Fidelity, Legal & General, Newton and Royal London to attend a presentation day to outline their funds in more detail. Note that CCLA, having completed the questionnaire process, were deliberately not included in the presentation process. The primary reason for this was that officers were comfortable that they already had a full understanding of the fund that would allow suitable comparison against alternatives. In addition to reviewing the funds in their own right, the process focussed on how each might "fit" into the Council's overall investment portfolio.

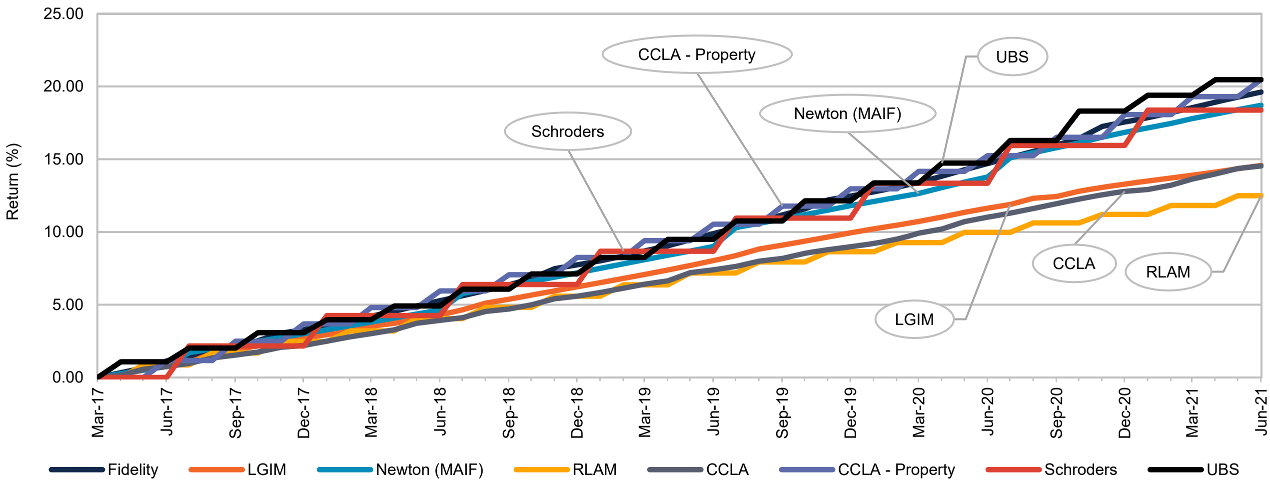
The following table provides periodic performance information spanning from one month to five years for the period ending June 2021. It breaks down overall performance (total return) into its component parts of income and capital, thus allowing for more detailed analysis of the main drivers. The top section provides details on the four funds invited to present to Council officers in early September. Meanwhile, the bottom section provides the same details for the four longer-term funds that the Council already invests with. Average figures, covering existing and potential new funds are presented in the middle of the table.

Cells colour-coded red in the table indicate a level that is below the overall average, while those coloured green indicate above average performance. Note also that some funds pay income periodically, so may not show figures in either the one, or three-month columns. Please also note that figures beyond one year are annualised, while those out to six months are not.

It is important to stress that while the bulk of funds detailed below are from the multi-asset class, the data also includes the CCLA property fund and the Schroders Fixed Income Fund. While data has been shown on a comparator basis, outright performance is not necessarily the only factor that needs to be considered. For example, the liquidity available in a property fund is far less than other funds, which are typically redeemable within a few days' notice. Further, the diversification benefits of not having longer-term investments all focussed in one asset class could be a consideration when reviewing the overall longer-term investment portfolio approach. Another consideration is the split between income and capital that these differing funds provide, where the table shows how funds can provide consistently above average income returns while capital performance is weaker than that seen across the fund mix.

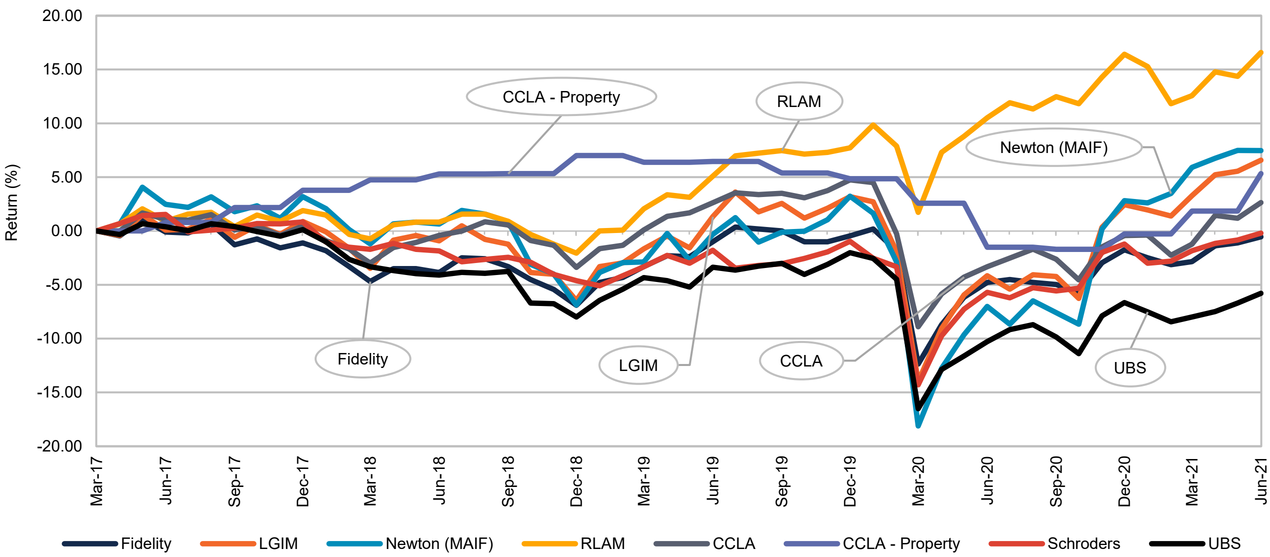
	Return	1M (%)	3M (%)	6M (%)	1YR (%)	3YR (%) *	5YR (%) *	Fund Size (£m)	Fees (OCF %)
Selected Funds for Final Presentation Day									
Fidelity (Apr 2007)	Total	0.86	3.30	3.00	8.95	5.55	5.38	1,250.37	0.58
	Capital	0.56	2.37	1.22	4.45	1.14	0.91		
	Income	0.30	0.90	1.75	4.29	4.35	4.42		
LGIM (Oct 2015)	Total	1.18	3.81	5.23	14.12	5.72	6.61	103.33	0.31
	Capital	0.97	3.19	4.04	11.21	2.46	3.24		
	Income	0.20	0.60	1.14	2.64	3.18	3.27		
Newton (MAIF) (Feb 2015)	Total	0.23	2.28	6.19	20.56	6.59	8.31	132.16	0.70
	Capital	-0.02	1.48	4.53	15.58	2.21	3.99		
	Income	0.26	0.78	1.60	4.34	4.30	4.18		
RLAM (Dec 2012)	Total	1.94	4.19	1.30	7.92	7.73	7.43	1,150.34	0.569
	Capital	1.94	3.57	0.14	5.50	4.96	4.51		
	Income	0.00	0.60	1.16	2.29	2.64	2.79		
Average Across All Funds	Total	0.90	3.35	4.49	13.17	5.19	6.08	-	-
	Capital	0.68	2.44	2.79	9.09	1.29	2.15		
	Income	0.22	0.89	1.66	3.74	3.85	3.85		
Funds Already Invested In									
CCLA (Dec 2016)	Total	1.60	4.74	4.67	9.54	4.34	-	138.60	1.23
	Capital	1.44	3.91	3.07	6.17	1.01	-		
	Income	0.15	0.80	1.55	3.17	3.29	-		
CCLA Property (Jan 1963)	Total	-	4.39	7.74	11.73	4.39	5.93	1,253.50	-
	Capital	-	3.43	5.63	6.94	0.01	1.37		
	Income	-	0.99	2.05	4.55	4.38	4.51		
Schroders (Apr 2006)	Total	0.65	1.67	3.19	10.64	5.01	4.64	641.23	-
	Capital	0.65	1.67	1.02	5.83	0.56	0.22		
	Income	0.00	0.00	2.10	4.44	4.33	4.31		
UBS (Oct 2009)	Total	0.97	3.31	2.78	10.32	4.15	3.58	40.31	-
	Capital	0.97	2.39	0.92	5.00	-0.60	-0.87		
	Income	0.00	0.89	1.83	5.00	4.72	4.44		

The Council will, therefore, need to balance a wide array of different considerations when deciding what mix of funds will be most appropriate for it moving forwards. For example, if the primary focus is seen as solely income, and consistency of income, then it may look to just those funds which produce the strongest levels. The following chart provides details on the cumulative income performance of all of the funds included in the table above.



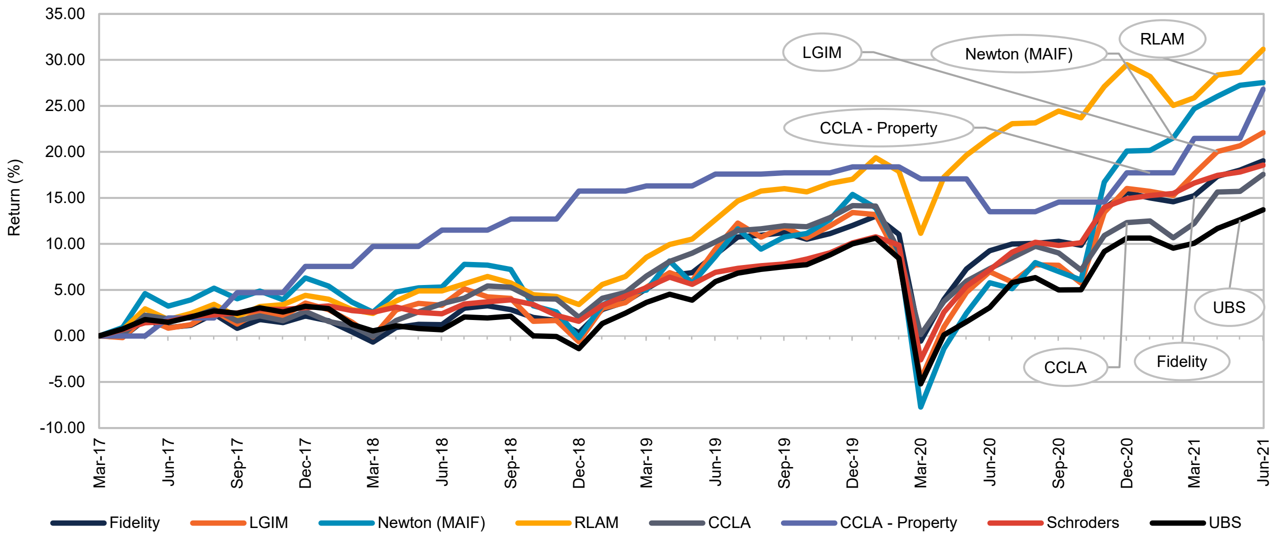
This would suggest that, over the longer term, the multi-asset fund from LGIM (Legal & General Investment Management), the CCLA Diversified Income Fund and the Royal London multi-asset fund while providing consistency of income, it is at a lower rate than that of the other funds under consideration. This chart uses April 2017 as its starting point (March is point 0) as this was the date when the Council made its most recent investment in a multi-asset fund (CCLA). While the timing of income distribution provides different profiles for the other funds, the chart would suggest that, over the longer term, they do provide greater overall levels of distributions to investors.

However, the Council should still consider whether this income is being generated at too great an expense in terms of capital performance and thus affecting overall returns in the longer term. The following chart provides the cumulative progress of capital of the funds under review over the same time period as the income chart above:



In contrast to the income chart, this chart shows that the weakest overall capital performance has come from UBS, with Royal London some way ahead of other funds under review. It also shows the potential diversification benefits of utilising funds from a range of asset classes. In this instance, the CCLA property fund was far less impacted through 2018 than other funds under review when markets were increasingly concerned about the global economic outlook. More recently, it shows the clear, but in some cases notably different impact of the pandemic upon market pricing. Least affected was Royal London, where its capital value returned to pre-pandemic levels by June 2020. This reflected the more conservative approach of the fund in terms of both its weighting towards equities (lower than that of other multi-asset funds under review) and greater focus on higher quality fixed income instruments. The CCLA property fund did see a weaking of its capital levels, but it was a more drawn-out process than the steep, sharp falls seen in most other funds. While the Schroders fund is fixed income focussed, it is allowed to invest more than 50% in sub investment grade bonds, which will typically be more affected by economic downturns than higher credit qualities, thus providing a more equity-like performance profile in capital movements during the height of the pandemic in 2020.

The final chart combines the income and capital performance on a cumulative basis. While UBS and Royal London have the strongest and weakest income elements to their performance, this is outweighed by what has happened in terms of capital movements for the respective funds through the period under review. The overall economic improvement seen through the latter stages of 2020 and into 2021 has benefitted all funds, with Newton seeing the strongest "rebound" from the depths of the pandemic impact. Evidently (and hopefully) pandemics are not regular occurrences for financial markets and economies to deal with. However, markets still move in cycles and while the income chart above would suggest that the impact on income is more limited, it does have a more material impact on capital movements. It is, therefore, important for the Council, when making its decision on the most suitable profile of funds to use in the future, to also consider how different funds can be affected through the different stages of an economic cycle and importantly how quickly they can recover. This could come into greater focus in the future if the current situation where the IFRS9 override forgoes capital movements (both up and down) to directly impact on balance sheet bottom lines. Similarly, while strong capital returns may allow an investor to "top slice" performance in any given period to support income, the volatility of capital movements is greater than that of income, even for more conservative focussed funds, means that this option is not assured.



Interest Rate Forecast

LINK GROUP FORECASTS

We do not think that the MPC will embark on a series of increases in Bank Rate of more than 0.50% during the current and next two financial years as we do not expect inflation to return to being sustainably above 2% during this period.

With unpredictable virus factors now being part of the forecasting environment, there is a risk that forecasts could be subject to significant revision during the next three years.

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e., equities, or the safe haven of government bonds. The overall longer-run trend is for gilt yields and PWLB rates to rise.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Link Group Interest Rate View			10.8.21								
	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

Balance Sheet Projections

Link use the Balance Sheet Review as a foundation to develop a forward projection which can be used as a strategic planning tool to inform the treasury management strategy over the medium term. Each key component from the Balance Sheet Review is projected forward to ascertain the potential impact of the capital programme, known movements in the external borrowing portfolio and expected movements in reserves and balances and working capital on the treasury management strategy of the Council. The movement of each of these elements has a direct impact on the forecast cash position of the Council and therefore the cumulative impact can be summarised to help inform both future investment and borrowing decisions.

This will be updated as and when new information becomes available and can provide a framework as to what is appropriate for the forecast financial position of the Council over the medium term, which can then be discussed in the context of the risk appetite of the Council.

The forward projections produced below is an initial draft based on the information currently available.

2019/20 (£'000)	CAPITAL FINANCING REQUIREMENT	2020/21 (£'000)	2021/22 (£'000)	2022/23 (£'000)	2023/24 (£'000)
45,813	GF	47,061	49,637	49,059	48,285
61,308	HRA	61,308	65,040	67,389	67,389
107,121	CFR	108,369	114,677	116,448	115,674
-	Finance Lease Liabilities	-	-	-	-
107,121	Underlying Borrowing Requirement	108,369	114,677	116,448	115,674
(104,615)	External Borrowing c/fwd	(104,615)	(100,365)	(108,347)	(108,347)
-	Loan Maturities	4,250	2,350	2,850	3,150
-	New Loans	-	(10,332)	(2,850)	(3,150)
(104,615)	External Borrowing	(100,365)	(108,347)	(108,347)	(108,347)
2,506	Under / (Over) Borrowing	8,004	6,330	8,101	7,327
2%	*Underborrowing as a % of Underlying Borrowing Requirement*	*7%*	*6%*	*7%*	*6%*
	RESERVES / BALANCES, INVESTMENTS & WORKING CAPITAL (£'000)				
2,242	General Fund Balance	2,243	4,434	5,186	5,886
750	Housing Revenue Account Balance (inc MRA)	2,796	750	750	3,640
(75)	Collection Fund Adjustment Account	(6,656)	(6,656)	(6,656)	(6,656)
7,462	Earmarked reserves	12,772	7,396	7,546	7,893
2,961	Capital Receipts Reserve	3,380	2,144	2,244	2,344
1,121	Provisions (exc. any accumulating absences)	2,001	2,001	2,001	2,001
5,627	Capital Grants Unapplied	6,463	6,508	7,240	8,303
20,088	Amount Available for Investment	22,999	16,577	18,311	23,411
22,244	External Investments	24,228	14,247	14,210	20,084
4,662	Working Capital (Deficit) / Surplus	9,233	4,000	4,000	4,000

The Council's CFR is forecast to increase from £108m to £116m in 2022/23 and Reserves and Balances is expected to fall from current levels to £18m in the same year. Loans which were taken during the HRA self-financing in 2012, has loans maturing each year. The projection assumes refinancing of the HRA loan as they mature and the additional HRA expenditure expected in 2021/22.

This year, 2021/22, if the Council's CFR increases to £114m as per the projection, the external investment balance falls from £24m to £14m. This is based on the assumption that the Council only refinances the HRA borrowing and does not take any new external borrowing, and therefore maintain an internal borrowing position of £6.7m (6% of the CFR).

If the Council wishes to adopt the strategy to maintain 6% of its CFR in internal borrowing this will:

- Reduce credit and counterparty risk
- Reduce the cost of carry

- And generate a net borrowing cost saving of £107k per annum (based on borrowing cost at 1.70%(50yr PWLB borrowing rate) and money market interest rate of 0.10%)

However, it is important to recognise this strategy is a temporary measure and that regular review is required to ensure that when this position is converted the Council is borrowing at favourable borrowing rates.

The Council will need to consider the level of long term investment it has. Based on the projections outlined above, the external investment balance falls to £14m at end 2021/22 and to remain at this level the following year before rising to £20m in 2023/24. In the near-term, this would indicate that £12m in long term investments maybe deemed excessive.

Accounting Implications

The CIPFA Code of Practice (the Code) adopted IFRS 9 Financial Instruments in 2018/19 and requires the classification of financial assets as either:

- Amortised Cost
- Fair Value through other Comprehensive Income (FVOCI)
- Fair Value through Profit of Loss (FVPL)
- The classification is determined by two factors:
- the authority's business model for managing the financial assets, and
- the contractual cash flow characteristics of the financial asset.

IFRS9 Classification	Code Reference	Business Model	Contractual Cash Flows
Amortised Cost	7.1.5.2	The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows	The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
FVOCI	7.1.5.3	The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets	The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
FVPL	7.1.5.4	All other combinations of business model and contractual cashflows	

The Council's current treasury investments are a combination of MMFs, USDBF's, MAIF's, Bond Fund and a property fund, classified as either amortised cost or FVPL.

The statutory override in respect of pooled funds, which is due to last 5 years from 2018/19 to 2022/23, currently results in unrealised gains and losses from pooled funds being taken to a specific unusable reserve on the balance sheet. The consultation outcome issued by MHCLG back in 2018 states that the Government would continue to keep the override under review and that the 5 year time horizon provided local authorities with time to consider their investment strategies over the medium term. We await further information as to what will happen at the end of 2022/23 and the Council should assess the potential impact of the override not being extended when monitoring its current pooled fund investments and when considering any future long term investment decisions which may be considered going forward.

We would always suggest that the decision to enter into such investments should be based on the financial position of the Council and the recognition of the appropriate time horizon and underlying risks associated with the investment in question.

Summary

This report has reviewed the current balance sheet position of the Council as well as the forward projection in order to establish if the Council has capacity to place further money over the longer term investment time horizon. The Multi Asset Income Fund Selection also presented the Council with the opportunity to review if its current managers are still fit for purpose, or whether there are alternative options which could be more appropriate for its requirements.

The balance sheet forward projection assumes CFR to increase to £114m in 2021/22, external borrowing remaining at £108.35m, therefore having an internal borrowing position of £6.3m. The projection assumes that the level of Reserves and Balances falls from £23m to £16.5m which means the Council's external investment balance will fall to c.£14m at year-end.

In a low interest rate environment, it is deemed prudent to maintain an internal borrowing position as this reduces the cost of carry and generates a net interest cost saving (cost of borrowing less investment income).

However, if the Council's external investment balance is expected to fall to the levels outlined above, it raises the question as to whether the Council can maintain having £12m in longer term focussed investment funds. The current investment position has been split into the following funds (original principal, then position as at end-June 2021):

- CCLA Property Fund - £4m / £4,300645
- Schroders Credit Fund - £3m / £2,957,826
- CCLA Diversified Income Fund - £2m / £2,032,376
- UBS Multi-Asset Income Fund - £3m / £2,843,639

The Fund Selection process and the review of all the performance data of each of the funds outlined in the previous section provided the following information on funds:

CCLA Property Fund – capital level had declined but was back above starting point by close of 2020/21. While weaker than the overall average, the main driver of property funds is income, which had been consistent and higher than average levels across other funds under consideration at 4.51% over past 5yrs.

Schroders Credit Fund (fixed income) – capital level had declined by similar magnitude to multi asset funds in both 2018 and early 2020. However, had also reverted higher in a similar vein as market conditions and economic outlooks improved. While below the average, modestly positive gains of 0.22% per annum over past 5yrs. Income both consistent and higher than average (3.85%), at 4.31% per annum, over the past 5yrs.

CCLA Diversified Income Fund (multi asset) – capital performance had improved from the depths of the pandemic. However, at 1.01%, it was below the average of other funds over the past 3yrs (fund does not have a 5yr track record). While consistent, income lower than average (also 3.85%) at 3.29% over the past 3yrs. Fees also appreciably higher than alternate multi asset funds included within selection process

UBS Multi-Asset Income Fund – the weakest capital performance of funds under review at -0.87% per annum over the past 5yrs. Income consistent and above average at 4.44% per annum over the last 5yrs. At just over £40m, the smallest fund included within this review.

Fidelity (multi asset) – below average capital performance but as with bulk of its peer group, the focus of this fund is on income. Nevertheless, at 0.91% per annum over last 5yrs it was stronger than a number of other similar funds under review. Income consistently amongst the highest tier of funds under review and at 4.42% per annum, it was higher than the average over the last 5yrs. Fund approach is "fund of funds" rather than individual investments, with key part of its investment process researching and analysing potential fund options with which to execute its investment ideas. One of two funds included within the review that takes this approach across whole of its fund.

LGIM (multi asset) – above average capital performance over past 5yrs at 3.24% per annum vs average of 2.15%. Income performance consistent but within the lower tier of funds under review. 3.27% per annum over past 5yrs. The other fund of fund approach but focus on risk appetite of investors with a number of different funds in the range that look to achieve more definitive outcomes based on investor risk appetite.

Newton (multi asset) – At 3.99% per annum over past 5yrs, capital performance among the strongest of funds under review. Was one of the weakest performers at the peak of the pandemic impact but rebound thereafter amongst the strongest. Average income of 4.18% per annum over last 5yrs above average and within top tier of funds under review.

Royal London (multi asset) – Strongest capital performance of funds under review at 4.51% per annum over past 5yrs. This performance reflected the more limited immediate impact of the pandemic due to fund's heavier bias towards higher quality fixed income instruments (typically 75%). However, in downturn of 2018, fund's capital performance was much in-line with other multi-asset funds. This approach also reflects weakest income performance at 2.79% per annum over last 5yrs. Fund positions itself as more a "total return" product for investors with the ability to top slide capital performance (where available) to support income.

In terms of moving forwards, the Council needs to consider both its current internal position and where it believes it will progress in the future (as outlined in the forward balance sheet projection) when considering what mix of funds would be most appropriate for its needs. Barring the property fund, all existing funds, as well as the potential new options are liquid, meaning that subscriptions / redemptions can be made in a short space of time. However, if the Council did look to divest itself of any existing fund, it will need to also consider the current capital values, as any shortfall would be an immediate hit to its finances. As detailed above, both CCLA funds were above original principal amounts at the end of June 2021. Meanwhile, Schroders was just below its original principal amount and UBS was lower by over £150,000.

Discussions with officers over the internal position has identified a bias towards income generation for its longer-term investments. This would suggest that the three funds in the lower tier of income generation (CCLA Diversified Income Fund, LGIM and Royal London) may not be the most appropriate for the Council at the present time. While Royal London has provided the strongest overall performance in the review section above, the bulk of this has come from capital, which, as shown, is the more volatile element of total return. The concern would be that if the fund did not generate sufficient capital appreciation, then the Council's ability to support its revenue budget through income and top-slicing capital of this fund could be compromised.

In terms of those funds with higher levels of income, capital performance again could play a part in the future path of the Council's investment portfolio. As detailed above, over the five year period to end June, UBS, while providing robust income levels, has shown the weakest overall return, with its capital position still over £150k below the original balance invested. While other multi-asset funds have seen similar shortfalls through the review period, they have seen capital bounce back. UBS has achieved a capital return of -0.87% per annum over the past 5 years, with the next weakest performance over 100 basis points higher (Schroders at 0.22%), per annum. Note that the difference in income performance is just 13 basis points, in favour of UBS. The four remaining funds, CCLA Property, Schroders Credit, Newton and Fidelity through the review period have combined higher tier income with more supportive capital profiles. They also maintain the Council's current diversification between investments in different asset classes. If the Council wished to move forwards using these funds then, as outlined above, it would need to consider its balance sheet position and potential exit strategy as part of any reallocation process.

Link would welcome the opportunity to discuss this report and support the Council in making its decision on future investment in more detail.

Appendix 1

TANDRIDGE DISTRICT COUNCIL

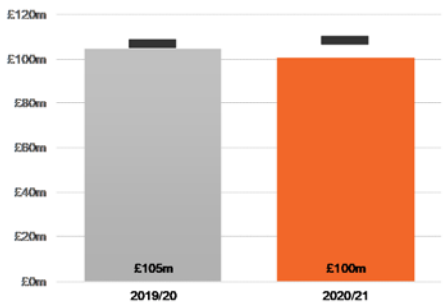
2020/21 Desktop Balance Sheet Review

LINK Group

CAPITAL FINANCING AND BORROWING (£'000)	2019/20	2020/21
Capital Financing Requirement (CFR)	107,121	**108,369**
Underlying Borrowing Requirement	107,121	**108,369**
External Borrowing	104,615	**100,365**
Internal Borrowing	2,506	**8,004**
Net Borrowing (exc TFR debt)	82,371	**76,137**
CFR per Statement of Accounts	106,936	**108,286**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Capital Financing Requirement (CFR)		
355,706	Property, Plant & Equipment	380,042	
21,680	Investment Property	6,170	
1,727	Intangible Assets	1,871	
21,991	Capital Investments (non-TM)	21,493	
(164,691)	Revaluation Reserve	(174,151)	
(129,292)	Capital Adjustment Account	(127,056)	
107,121	**CFR (as per Prudential Code)**	**108,369**	**1,248**
107,121	**Underlying Borrowing Requirement**	**108,369**	**1,248**
	External Borrowing		
(4,250)	Short-Term	(2,350)	
(100,365)	Long-Term	(98,015)	
(104,615)	**TOTAL External Borrowing (Principal)**	**(100,365)**	**4,250**
2,506	Internal Borrowing	8,004	5,498

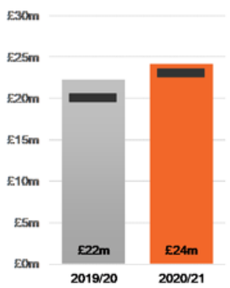
External Borrowing vs Underlying Borrowing Requirement



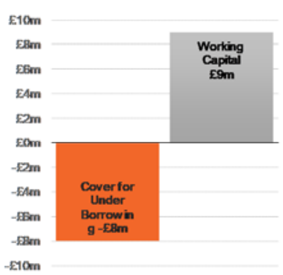
RESERVES / BALANCES AND INVESTMENTS (£'000)	2019/20	2020/21
Balances Available for Investment	20,088	**22,999**
External Investments	22,244	**24,228**
Surplus Monies	(2,156)	**(1,229)**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Reserves / Balances		
(2,242)	General Fund Balance	(2,243)	
(750)	Housing Revenue Account Balance	(2,796)	
75	Collection Fund Adjustment Account	6,656	
(7,462)	Earmarked reserves / other balances	(12,772)	
(2,961)	Capital Receipts Reserve	(3,380)	
(1,121)	Provisions (exc. any accumulating absences)	(2,001)	
(5,627)	Capital Grants Unapplied	(6,463)	
(20,088)	**Amount Available for Investment**	**(22,999)**	**(2,911)**
	Investments		
10,903	Short-Term	14,592	
5,992	Long-Term	6,114	
4,520	Cash & Cash Equivalents - Investments / Deposit	3,250	
829	Cash & Cash Equivalents - Other (Bank / Cash)	272	
22,244	**TOTAL Investments**	**24,228**	**1,984**
2,156	Surplus Monies	1,229	(927)

Investments vs Balances



Analysis of Surplus Monies



WORKING CAPITAL (£'000)	2019/20	2020/21
TOTAL Working Capital (Surplus)	(4,662)	**(9,233)**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Working Capital		
5,787	Debtors	14,666	8,879
(10,978)	Creditors	(23,679)	(12,701)
85	Stock / WIP	83	
(5,106)	**NET Working Capital (Surplus)**	**(8,930)**	**(3,824)**
	Other		
113	Balance LT Debtors	113	
(650)	Balance of LT Liabilities	(650)	
981	FIAA - Premiums, (Discounts) etc	-	
-	Pooled Investment Funds Adjustment Account	234	
444	**Other Long-Term Working Capital**	**(303)**	**(747)**
(4,662)	TOTAL Working Capital (Surplus)	(9,233)	(4,571)

Analysis of Working Capital