Appendix A

Overview

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on these activities.

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act.

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities. A Revised edition of this code was published in November 2011.

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services. A Revised edition of this code was also published in November 2011.

- Under the Act the Communities and Local Government office (CLG) has issued Investment Guidance to structure and regulate the Council's investment activities. This was updated with effect from 1st April 2010, as a result of reports into Local Government investments by the Audit Commission and the Treasury Select Committee.

Treasury Management Policy Statement

<u>Introduction and Background</u>

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management: -

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.

- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. Full Council Members) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review, and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance & Performance as Section 151 Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

<u>Policies and Objectives of Treasury Management Activities</u>

2.1 The Council defines its treasury management activities as: -

> *"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

2.2 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important, but are secondary considerations.

Appendix B

CIPFA report limitations

As from 2016-17 SCC no longer subscribes to the CIPFA Treasury Management Benchmarking Club. CIPFA Treasury Management Benchmarking Club produces detailed reports of Local Authority performance, and also compares with other authorities. Whilst these headline figures have been a useful guide in assessing performance in the past, it has been equally important to assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management.

In view of the declining numbers that had been using the service, the increasing difficulty of straightforward comparison, and the cost of membership of the Benchmarking Club, it was decided not to participate from 2016-17 forward.

The number of Authorities using the benchmarking club has reduced over the past few years. In 2009-10 there were 136 participants, 95 in 2010-11, 84 in 2011-12, 68 in 2012-13, 50 in 2013-14, and 41 in 2014-15.

Many Authorities are using more esoteric means of ‘investing’ cash making it increasingly difficult to compare levels of risk tolerance, as well as returns. Some recent ‘investments’ by other Local Authorities include:-

- Investments in Solar Farms
- Loans to local Football Club
- Buy and Leaseback of BP Corporate HQ
- 33% Stake in new start-up bank
- Direct property investment

The many factors that affect treasury performance that were not apparent from the CIPFA reports, and thereby made direct comparison increasingly difficult included: -

- The CIPFA reports look at one year in isolation. With the introduction of the Prudential Code in 2004, Authorities have been able to invest for longer periods. Performance of investments in particular, needs to be viewed over a longer timeframe to see the full impact of decisions. A further issue regarding timeframes is that LOBOs can be taken and reported with a reduced rate initially, but with a big increase after an initial period that is not apparent in the reporting period.

- Each authority will have different needs during any given year. For example, a large capital requirement in a year when borrowing rates are high can have an enormous adverse affect on the overall portfolio performance for years to come. Conversely, a high rate loan that drops out of a small portfolio can make performance look extremely impressive in a year when no activity was undertaken, or if new borrowing is being undertaken in the present low rate environment.

- Individual decisions are taken to suit a Council's particular circumstances, return aspirations, overall policy, and risk tolerances, and these will affect outcomes. The techniques and tools used to achieve objectives, and as part of risk management will also have an effect. For example, District Councils with housing stock receipts can invest in longer-dated Government and Supranational Bonds, or place a greater percentage of investments with longer maturities.

- Investment returns compare rates achieved and give a general indication of length of deposits, but comparisons of the different levels of risk from counterparties and duration of loans is not available.

- The size of an Authority's cash balances will affect returns. An Authority with larger balances may be forced to use counterparties paying a lower rate to satisfy diversification needs and maintain minimum counterparty criteria.

- Use of Advisors. Authorities' lending lists will be heavily influenced by their Treasury advisors. Who each Authority's advisor is, and therefore their investment and counterparty advice, is not apparent from CIPFA reports.

- The number of Authorities using the benchmarking club has reduced over the past few years. In 2009-10 there were 136 participants, 95 in 2010-11, 84 in 2011-12, 68 in 2012-13, 50 in 2013-14, and 41 in 2014-15. There is anecdotal evidence that some Authorities have adopted an extremely risk-averse position, and at times for some, all deposits have been with the UK Government via the DMO. It is not beyond the realms of possibility that Authorities that follow extremely risk-averse strategies may be less inclined to measure and compare their outcomes.

Appendix C

The Economy and Events in 2016-17 including Market and PWLB Rates

Politically, 2016-17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected the 45th President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility in 2016. Article 50, which set in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

Inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Sterling exchange rate following the referendum had an impact on import prices which, together with rising energy prices, resulted in inflation rising from 0.3% year-on-year in April 2016 to 2.3% year-on-year in March 2017.

In addition to the political fallout, the referendum's outcome also prompted a sharp decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee (MPC) to cut the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

Despite growth forecasts being downgraded, economic activity was fairly buoyant and GDP grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of 2016. The labour market also proved resilient, with the ILO unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

Following a strengthening labour market, in moves that were largely anticipated, the US Federal Reserve increased rates at its meetings in December 2016 and March 2017, taking the target range for official interest rates to between 0.75% and 1.00%.

Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. Since September there has been a reversal in longer dated gilt yields which have moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, which is almost back at pre-referendum levels of 1.37% on 23rd June. 20- and 50-year gilt yields have also risen considerably in the third quarter to 1.76% and 1.70% respectively, however in the fourth quarter yields have remained flat at around 1.62% and 1.58% respectively.

After recovering from an initial sharp drop in Quarter 2, equity markets rallied, although displaying some volatility at the beginning of November following the US presidential election result. The FTSE-100 and FTSE All Share indices closed at 7342 and 3996 respectively on 31st March, both up 18% over the year. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

Money market rates for overnight and one week remained low since Bank Rate was cut in August, at 0.10% and 0.13% respectively.

Lending rates for all periods moved significantly in August, in response to the unexpected bank base rate reduction, which was in response to the equally unexpected vote to leave the EU in June. 3-month, 6-month and 12-month LIBID rates had averaged 0.46%, 0.61% and 0.90% respectively during 2015-16, but decreased by 0.14%, 0.15%, and 0.20% respectively during 2016-17. 3-month, 6-month and 12-month LIBID rates ended the year at 0.22%, 0.37% and 0.61% respectively. An anomaly in the pricing of risk saw that the 2-year SWAP rate averaging 0.09% less than a 1-year deposit. A summary of PWLB and key benchmark rates is included below.

PWLB Rates 2016-17 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	10 Year EIP	30 Year	50 Year
01/04/2016	1.33	1.82	1.50	2.51	1.86	3.33	3.15
30/04/2016	1.37	1.95	1.59	2.65	1.99	3.40	3.21
31/05/2016	1.36	1.93	1.58	2.56	1.97	3.26	3.07
30/06/2016	1.15	1.46	1.23	2.06	1.49	2.79	2.53
31/07/2016	1.07	1.31	1.13	1.84	1.34	2.65	2.44
31/08/2016	1.09	1.23	1.12	1.65	1.25	2.29	2.08
30/09/2016	1.03	1.21	1.06	1.72	1.23	2.45	2.30
31/10/2016	1.16	1.64	1.34	2.27	1.67	2.88	2.69
30/11/2016	1.01	1.66	1.26	2.43	1.70	3.00	2.77
31/12/2016	0.97	1.55	1.19	2.28	1.59	2.81	2.66
31/01/2017	1.08	1.74	1.34	2.50	1.79	3.07	2.88
28/02/2017	1.00	1.44	1.15	2.14	1.48	2.83	2.64
31/03/2017	1.03	1.44	1.16	2.11	1.48	2.76	2.54
Minimum	0.96	1.15	1.03	1.62	1.17	2.27	2.07
Average 2016-17	**1.13**	**1.56**	**1.28**	**2.21**	**1.60**	**2.89**	**2.69**
Maximum	1.40	2.00	1.63	2.71	2.04	3.46	3.28
Spread	0.44	0.85	0.60	1.09	0.87	1.19	1.21
Average 2015-16	**1.41**	**2.20**	**1.76**	**2.85**	**2.25**	**3.54**	**3.42**
Difference in average	**-0.28**	**-0.64**	**-0.48**	**-0.64**	**-0.65**	**-0.65**	**-0.73**

Money Market Rates 2016-17 (LIBID Source = BBA)

	O/N LIBID	7-Day LIBID	1-Month LIBID	3-Month LIBID	6-Month LIBID	12-Month LIBID	2-Yr SWAP
01/04/2016	0.36	0.36	0.39	0.46	0.61	0.88	0.78
30/04/2016	0.36	0.36	0.38	0.47	0.62	0.90	0.86
31/05/2016	0.35	0.37	0.39	0.46	0.61	0.89	0.82
30/06/2016	0.35	0.36	0.39	0.43	0.55	0.80	0.49
31/07/2016	0.35	0.34	0.31	0.37	0.46	0.68	0.47
31/08/2016	0.10	0.12	0.15	0.26	0.40	0.61	0.42
30/09/2016	0.10	0.12	0.14	0.26	0.41	0.63	0.43
31/10/2016	0.10	0.12	0.14	0.28	0.44	0.69	0.61
30/11/2016	0.10	0.13	0.14	0.26	0.43	0.67	0.65
31/12/2016	0.09	0.11	0.13	0.24	0.41	0.65	0.60
31/01/2017	0.10	0.12	0.14	0.23	0.41	0.65	0.69
28/02/2017	0.10	0.12	0.14	0.23	0.39	0.61	0.56
31/03/2017	0.10	0.11	0.13	0.22	0.37	0.61	0.61
Minimum	0.09	0.11	0.13	0.22	0.37	0.59	0.38
Average 2016-17	**0.19**	**0.20**	**0.22**	**0.32**	**0.46**	**0.70**	**0.61**
Maximum	0.36	0.37	0.39	0.47	0.62	0.90	0.88
Spread	0.27	0.26	0.26	0.25	0.25	0.31	0.50
Average 2015-16	**0.36**	**0.36**	**0.38**	**0.46**	**0.61**	**0.90**	**0.96**
Difference in average	**-0.17**	**-0.16**	**-0.16**	**-0.14**	**-0.15**	**-0.20**	**-0.35**

Appendix D

The Portfolio Position as at 31st March 2017 and a comparison with 2016 is set out below: -

	31st March 2016 £m	31st March 2017 £m	Change £m
Borrowing – Long-term			
Public Works Loan Board	159.05	159.05	0.00
Rate (%)	4.59	4.59	0.00
Market loans	170.5	170.5	0.00
Rate (%)	4.72	4.72	0.00
Sub-total	**329.55**	**329.55**	**0.00**
Rate (%)	**4.66**	**4.66**	**0.00**
Short-Term Borrowing			
External Borrowing	0.0	0.0	**0.0**
Total Borrowings	**329.55**	**329.55**	**0.0**
Cash Managed on behalf of others			
ENPA / SWRB	0.23	0.00	-0.23
Organisations in the Comfund	9.88	9.64	-0.24
Total	**10.11**	**9.64**	**-0.47**
Lending			
Revenue Lending	13.17	7.86	-5.31
Rate (%)	0.57	0.35	-0.22
Comfund Investment	254.36	211.31	-43.05
Rate (%)	0.86	0.69	-0.17
Total Lending	**267.53**	**219.17**	**-48.36**
Rate (%)	**0.85**	**0.68**	**-0.17**

The Council's need to borrow for capital purposes is determined by the Capital Programme and Capital Strategy. Council Members were aware of the major projects identified for 2016 to 2019. All Capital projects were to be funded from Capital Receipts and Grant allowances from central Government, thereby eliminating the need to borrow for 2016-17.

During 2016-17, there were no scheduled debt maturities. Both the PWLB and LOBO portfolios remained the same.

The cash managed on behalf of others includes that of Exmoor National Park Authority (ENPA) and the South West Regional Board (SWRB). SCC continues to manage revenue balances on their behalf, and under contractual arrangements sweeps their cash into the SCC account daily, from where it is lent into the market in the name of SCC. There are arrangements in place for the allocation of interest received on these amalgamated balances, and SCC should not be at a disadvantage as rates paid to ENPA and SWRB should always be less than those achieved by the investments.

The same principle holds for the Comfund external investors (a limited group of not-for-profit organisations with links to SCC) but here, the rate achieved is passed on to investors and an admin fee is charged.

In addition, during 2016-17, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. A grant of £56.7m was received on 11th April 2016.

Revenue balances held on behalf of others at year-end decreased from £0.23m to £0.00m. Investment in the Comfund by external bodies decreased slightly, from £9.88m to £9.64m.

The Comfund investment of £211.31m was £43.05m lower, whilst revenue lending was also reduced by £5.31m, resulting in less cash earning a lesser rate of interest, as bank rate was cut to 0.25% in August.

Total lending as at 31st March 2017, including unspent LEP money, stood at over £219m, a decrease of £48m from 2016.

Appendix E

Temporary Borrowing

There were no temporary loans taken during 2016-17.

The nature of the deposit yield-curve throughout the year meant that the benefit of investing in shorter periods up to 2 or 3 months was marginal. The majority of revenue balances were therefore kept in Call Accounts and Constant Net Asset Value (CNAV) Money Market Funds. These not only reduced counterparty risk while providing returns superior to short-term deposits, but also provided minimal liquidity risk through instant access.

The benefits of not needing to borrow meant a year of zero interest paid on temporary loans.

Another benefit is nil temporary borrowing brokerage fees.

Appendix F

Long-Term Borrowing

The rate at which the Council can borrow from its main source, The PWLB, is directly affected by Market movements in Gilts (PWLB rates are set with a direct correlation to Gilt yields). They are set twice daily and fluctuate according to market sentiment.

UK Government Gilts are the main beneficiary when negative sentiment is felt (uncertainty in the lead up to the UK vote on whether to leave the EU, and the subsequent outcome, uncertainty over the US Presidential election, and doubts over European and Chinese growth). Greater demand = higher price = lower yield = lower PWLB rates. The opposite holds true, i.e. positive sentiment translates into higher yields.

Gilt yields across all durations ended the year lower than in March 2016, the third year of reducing yields. For maturity rates over 1-year, reductions were seen all along the curve, 5-year Gilts losing 0.45% and 50-year, 0.56%.

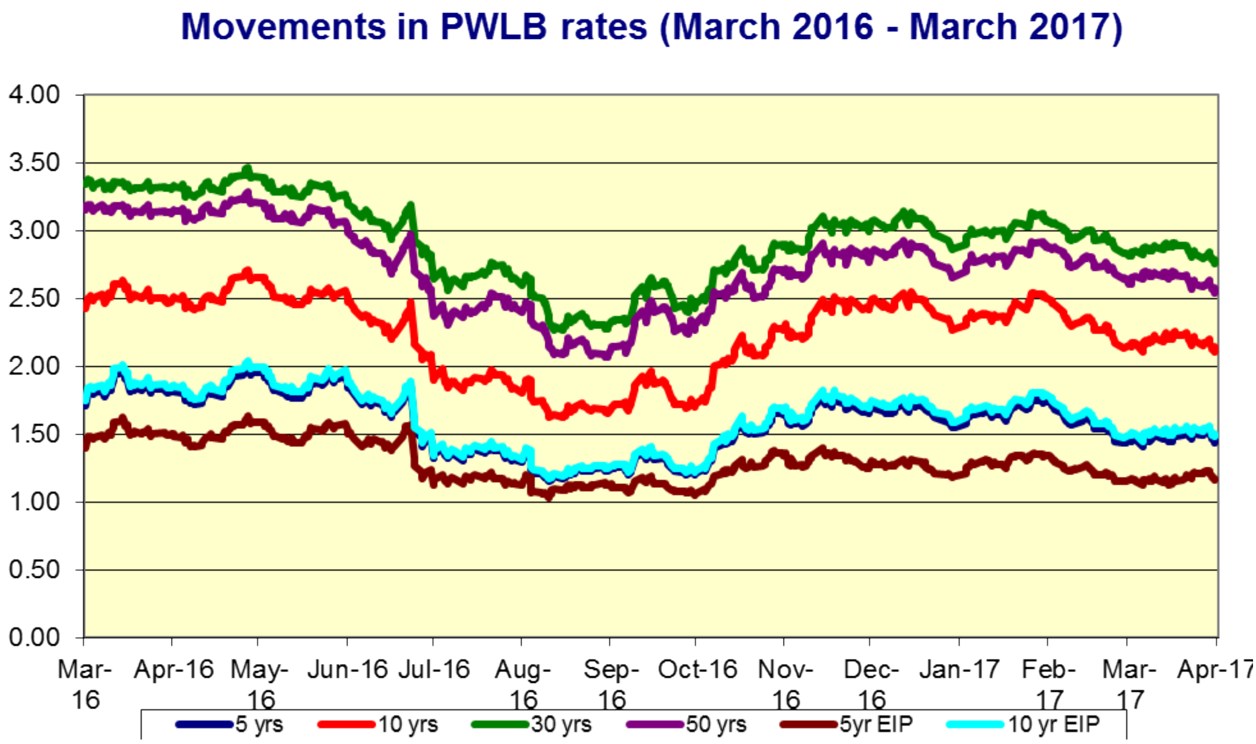
The PWLB 50-year maturity rate averaged 2.69% for the year, 0.73% down on 2015-16. The trend was repeated for 5, 10, and 30-year, where average yields reduced by 0.64%, 0.64%, 0.65% respectively. Spreads across all maturities over 5-years were volatile, the five-year Maturity rate showing a maximum of 2.00% and a minimum of 1.15%, and the 50-year Maturity rate a maximum of 3.28% and a minimum of 2.07%, producing volatile spreads of 0.85% and 1.21% respectively during the year.

When yields decline, it becomes more expensive to repay debt prematurely. To give an example, to repay the entire PWLB portfolio in March 2014 would have incurred a premium of £33.5m. By March 2015 this had increased to £73.8m as yields fell, and further to £79m by the end of March 2016. During 2016-17 with yields falling further, a year-high premium of £130m would have been payable in August, ending the year in March at £103m. Any decision to reschedule or repay debt would need to be taken in this dynamic environment.

The table and graph below summarise PWLB borrowing rates during the year.

PWLB Rates 2016-17 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	10 Year EIP	30 Year	50 Year
01/04/2016	1.33	1.82	1.50	2.51	1.86	3.33	3.15
30/04/2016	1.37	1.95	1.59	2.65	1.99	3.40	3.21
31/05/2016	1.36	1.93	1.58	2.56	1.97	3.26	3.07
30/06/2016	1.15	1.46	1.23	2.06	1.49	2.79	2.53
31/07/2016	1.07	1.31	1.13	1.84	1.34	2.65	2.44
31/08/2016	1.09	1.23	1.12	1.65	1.25	2.29	2.08
30/09/2016	1.03	1.21	1.06	1.72	1.23	2.45	2.30
31/10/2016	1.16	1.64	1.34	2.27	1.67	2.88	2.69
30/11/2016	1.01	1.66	1.26	2.43	1.70	3.00	2.77
31/12/2016	0.97	1.55	1.19	2.28	1.59	2.81	2.66
31/01/2017	1.08	1.74	1.34	2.50	1.79	3.07	2.88
28/02/2017	1.00	1.44	1.15	2.14	1.48	2.83	2.64
31/03/2017	1.03	1.44	1.16	2.11	1.48	2.76	2.54
Minimum	0.96	1.15	1.03	1.62	1.17	2.27	2.07
Average 2016-17	**1.13**	**1.56**	**1.28**	**2.21**	**1.60**	**2.89**	**2.69**
Maximum	1.40	2.00	1.63	2.71	2.04	3.46	3.28
Spread	0.44	0.85	0.60	1.09	0.87	1.19	1.21
Average 2015-16	**1.41**	**2.20**	**1.76**	**2.85**	**2.25**	**3.54**	**3.42**
Difference in average	**-0.28**	**-0.64**	**-0.48**	**-0.64**	**-0.65**	**-0.65**	**-0.73**



During 2016-17, there were no scheduled debt maturities, and due to the elevated premiums, rescheduling of existing debt was not cost effective.

The year-end average rate of the PWLB portfolio remained at 4.59%.

The Council has £170.5m of loans that are LOBO loans (Lender's Option Borrower's Option) of which all but £25m were in their option state during 2016-17. None of the lenders exercised their option to request an increase in the rate applied. As stated in the 2016-17 Treasury Management Strategy Statement (point 2.5), it is SCC policy not to accept any option to pay a higher rate of interest on LOBO loans, and would invoke its own option to repay the loan.

In June, Barclays Bank announced that they had waived all their rights to the options on the LOBO loans that they made. This included the £57.5m held by SCC. These loans are now effectively long-term fixed loans. Whilst it may have been beneficial to SCC for the loans to be called in the present environment, the likelihood of this was extremely low. The forfeiture of options does give more certainty to the SCC Market Loan portfolio in the longer-term.

The weighted average LOBO rate for SCC for the year was 4.72%.

With no debt activity during the year, the weighted average term for SCC market loans at 31st March was 34.74 years, whilst the PWLB loans average was 27.2 years.

Appendix G

Lending

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security: Security of capital remained the Council's main investment objective. This was maintained by following the counterparty policy as set out in the Annual Investment Strategy, and by the approval method set out in the Treasury Management Practices. Current approved counterparties are listed below. Those used during the year are denoted with a star.

Bank or Building Society		**Bank or Building Society**	
Australia & NZ Bank	*	Santander UK	*
Bank of Scotland	*	Standard Chartered Bank	*
Bank of Montreal	*	Svenska Handelsbanken	*
Bank of Nova Scotia		Toronto-Dominion Bank	*
Barclays Bank Plc		United Overseas Bank	*
Canadian Imperial Bank of Commerce			
Close Brothers Ltd	*		
Commonwealth Bank of Australia	*	**Sterling CNAV Money Market Funds**	
DBS Bank Ltd	*	Blackrock MMF	
Goldman Sachs International Bank	*	Goldman Sachs MMF	
HSBC Bank	*	Deutsche MMF	
Landesbank Hessen-Thuringen	*	Invesco Aim MMF	*
Lloyds Bank	*	Federated Prime MMF	*
National Australia Bank	*	JP Morgan MMF	*
National Westminster	*	Insight MMF	*
Nationwide BS	*	Standard Life MMF	*
Nordea Bank	*	LGIM MMF	*
OP Corporate Bank	*		
Oversea-Chinese Banking Corporation	*	**Other Counterparties**	
Rabobank	*	Other Local Authorities	*
Royal Bank of Scotland		Debt Management Office	

SCC has continuously monitored counterparties, and all ratings of proposed counterparties have been subject to verification on the day, immediately prior to investment. Other indicators taken into account have been:-

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.

Although the global financial situation continued to stabilise, there were still many events that affected the creditworthiness of financial institutions.

Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune, although the fall in their share prices was less pronounced.

Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. Fitch, S&P and Moody's have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

None of the banks on the Council's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although Royal Bank of Scotland was one of the weaker banks in both tests.

The tests were based on banks' financials as at 31st December 2015, 11 months out of date for most. As part of creditworthiness research and advice, analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) – is regularly received to determine whether there would be a bail-in of senior investors, such as local authority unsecured investments, in a stressed scenario.

New investments with Standard Chartered Bank were suspended in March 2016 due to its' relatively high credit default swap (CDS) level and disappointing 2015 financial results. The Council's two deposits with Standard Chartered at that time, matured in July and August 2016. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, and significant reduction in its' CDS price.

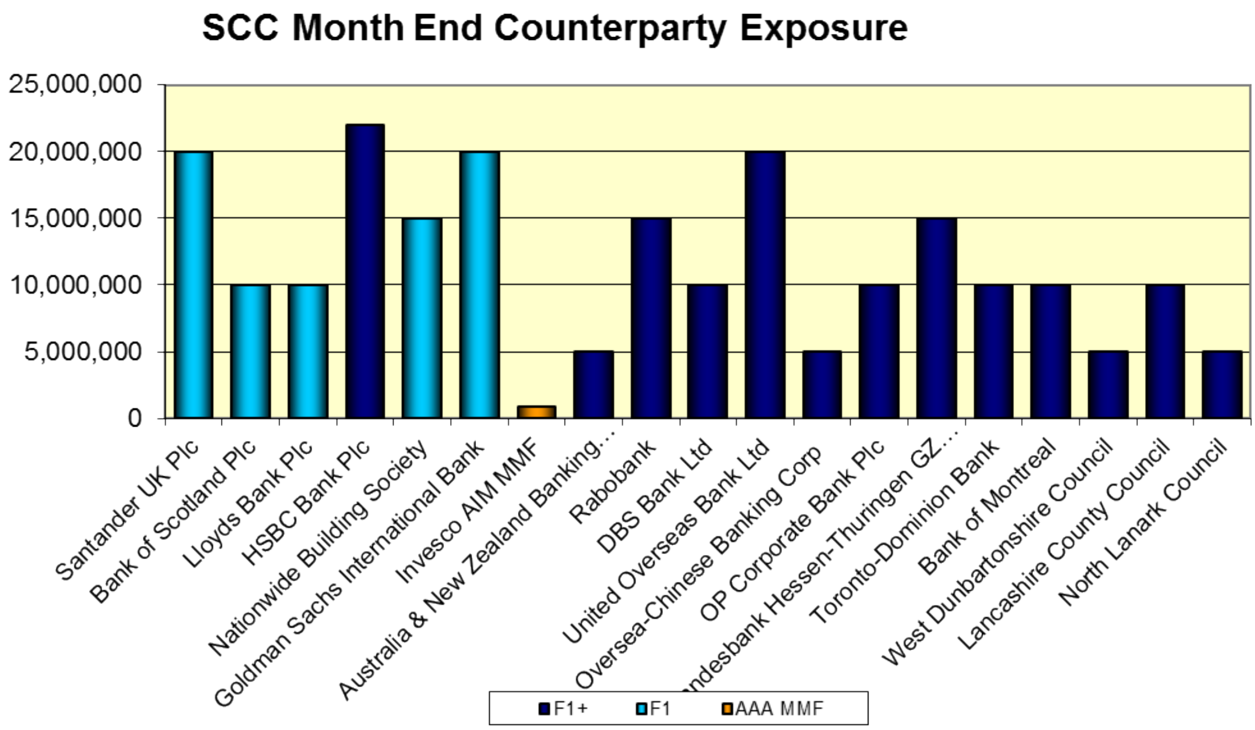
At year-end maximum durations per counterparty were as follows: -

- Nat West & RBS – **35 days;**
- Barclays, Goldman Sachs International, and Standard Chartered – **100 days;**
- Nationwide BS, Santander UK, OP Corporate, Landesbank Hessen-Thuringen and all Australian banks – **6-months;**
- HSBC, Bank of Scotland, Lloyds, Nordea, Rabobank, Svenska Handelsbanken, and all Canadian and Singaporean banks – **13-months;**

Another means of assessing inherent risk in an investment portfolio is to monitor the duration, the average weighted time to maturity of the portfolio. As the revenue element of lending is generally instant access or short-term lending, it is more appropriate to monitor the Comfund element of lending. The Comfund portfolio started the year with a duration of 154 days. This peaked in May and August at 169 days, and ended the year at 152 days. The average Comfund duration for the year was 163 days (146 in 2015-16).

In order to maintain diversification of the portfolio, some deposits were placed with UK Local Authorities. This allowed for longer-dated maturities with excellent creditworthiness and an appropriate yield.

The chart below shows the names of approved counterparties with deposit exposures as at 31st March 2017.



Liquidity: In keeping with the CLG guidance, the Council maintained a sufficient level of liquidity through the use of call accounts, money market funds (MMFs), and short-term deposits. Some call accounts and MMFs offered yields in excess of those on offer for time deposits up to 3-months, which meant that it was beneficial to use these facilities. This was beneficial not just for liquidity and yield, but in mitigating counterparty and interest rate risk. During the year, identified core balances and reserves have been lent for longer periods when deemed appropriate, via the Comfund. The Comfund aim is to create a portfolio of deposits with a rolling maturity providing sufficient liquidity, whilst enabling advantage to be taken of the extra yield offered in longer periods.

Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. UK Bank Rate halved to 0.25% in August, with the possibility of even lower rates to come. With increased uncertainty following the vote to leave the EU, deposit rates continued along the even lower for even longer path. 3-month, 6-month and 12-month LIBID rates had averaged 0.46%, 0.61% and 0.90% respectively during 2015-16. Rates remained at these levels until the outcome of the referendum was known in June, when rates began to decline. They reduced dramatically when bank base rate was cut in August, all ending the year approximately 0.25% lower. The average 3, 6, and 12-month rates lost 0.14%, 0.15%, and 0.20% respectively, to 0.32%, 0.46% and 0.70% for 2016-17. A table of rates is shown below.

Money Market Rates 2016-17 (LIBID Source = BBA)

	O/N LIBID	7-Day LIBID	1-Month LIBID	3-Month LIBID	6-Month LIBID	12-Month LIBID	2-Yr SWAP
01/04/2016	0.36	0.36	0.39	0.46	0.61	0.88	0.78
30/04/2016	0.36	0.36	0.38	0.47	0.62	0.90	0.86
31/05/2016	0.35	0.37	0.39	0.46	0.61	0.89	0.82
30/06/2016	0.35	0.36	0.39	0.43	0.55	0.80	0.49
31/07/2016	0.35	0.34	0.31	0.37	0.46	0.68	0.47
31/08/2016	0.10	0.12	0.15	0.26	0.40	0.61	0.42
30/09/2016	0.10	0.12	0.14	0.26	0.41	0.63	0.43
31/10/2016	0.10	0.12	0.14	0.28	0.44	0.69	0.61
30/11/2016	0.10	0.13	0.14	0.26	0.43	0.67	0.65
31/12/2016	0.09	0.11	0.13	0.24	0.41	0.65	0.60
31/01/2017	0.10	0.12	0.14	0.23	0.41	0.65	0.69
28/02/2017	0.10	0.12	0.14	0.23	0.39	0.61	0.56
31/03/2017	0.10	0.11	0.13	0.22	0.37	0.61	0.61
Minimum	0.09	0.11	0.13	0.22	0.37	0.59	0.38
Average 2016-17	**0.19**	**0.20**	**0.22**	**0.32**	**0.46**	**0.70**	**0.61**
Maximum	0.36	0.37	0.39	0.47	0.62	0.90	0.88
Spread	0.27	0.26	0.26	0.25	0.25	0.31	0.50
Average 2015-16	**0.36**	**0.36**	**0.38**	**0.46**	**0.61**	**0.90**	**0.96**
Difference in average	**-0.17**	**-0.16**	**-0.16**	**-0.14**	**-0.15**	**-0.20**	**-0.35**

Comfund

Comfund investment decreased to £211.31m at year-end 2017, by £43.05m from the £254.36m at year-end 2016.

The total of other investors' balances also decreased slightly by £0.24m.

The average balance of the Comfund throughout 2016-17 was £250m, a £7.8m decrease on the previous years' average.

The Comfund vehicle, with an annual return of 0.77% out-performed the benchmark for the year, by 0.35%.

A total of approximately £1.93m was earned in interest in the year, a decrease of £160,000 on the figure for 2015-16 of £2.09m. The rate achieved was only 4 basis points lower in an environment where available rates and balances were significantly reduced.

Comfund administration charges received from investors totalled approximately £38,500 for the year.

Revenue

Revenue balances averaged £35.5m during the year, with a yield of 0.42%. This compares favourably to a normal money market fund benchmark of 7-day LIBID (London Interbank Bid Rate, an average of bid rates that banks are willing to lend to each other), the average for which was 0.20%. This income stream earned interest of over £148,000.

Combined

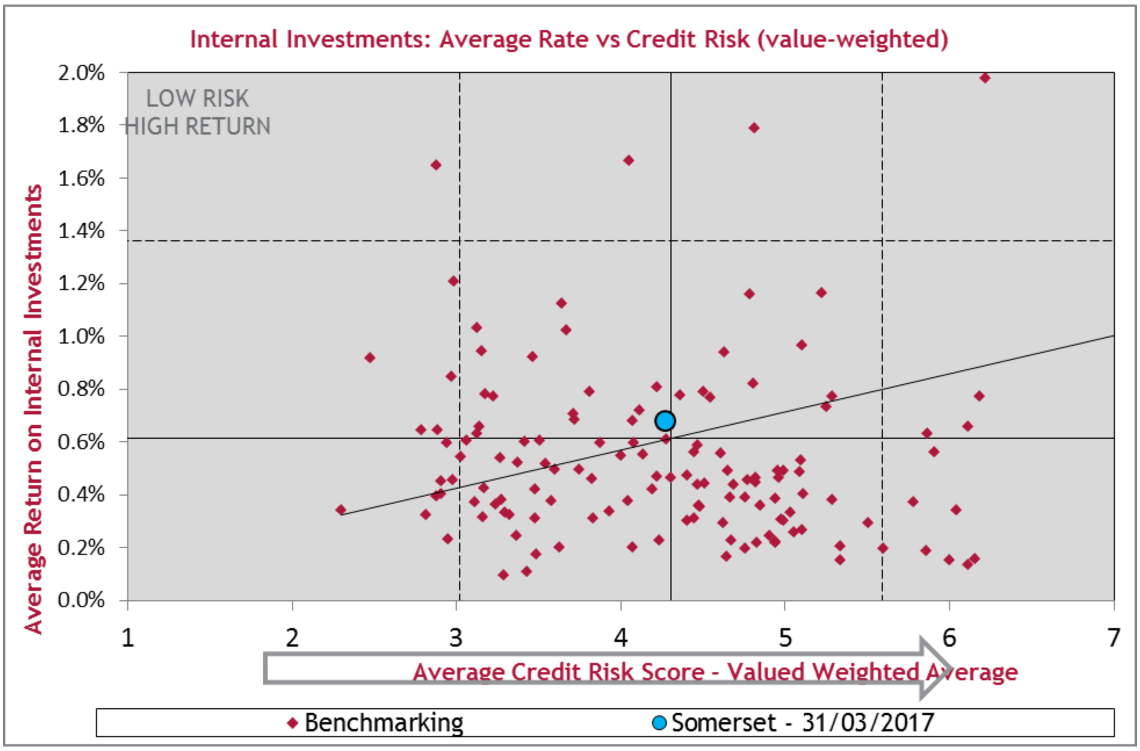
The combined average daily balance of the Council's investments during 2016-17 was £285.5m against £312.9m for 2015-16. The overall weighted investment return of combined in-house investments was 0.73% against a return of 0.75% for 2015-16.

2016-17 was the eighth complete year that SCC had the services of retained Treasury advisors, Arlingclose. It would therefore seem appropriate to look at SCC performance compared with other Authorities that use Arlingclose, i.e. that share much of the same investment advice, particularly regarding counterparties. However, many of the caveats mentioned in appendix B may apply. Furthermore, it has become apparent that many Authorities currently have exposure to Property Funds in their Treasury portfolios. With this in mind, a more equitable comparator, figures for internally managed investments only, has been used. The Arlingclose report compares quarter-end figures only, and comparisons can be seen below.

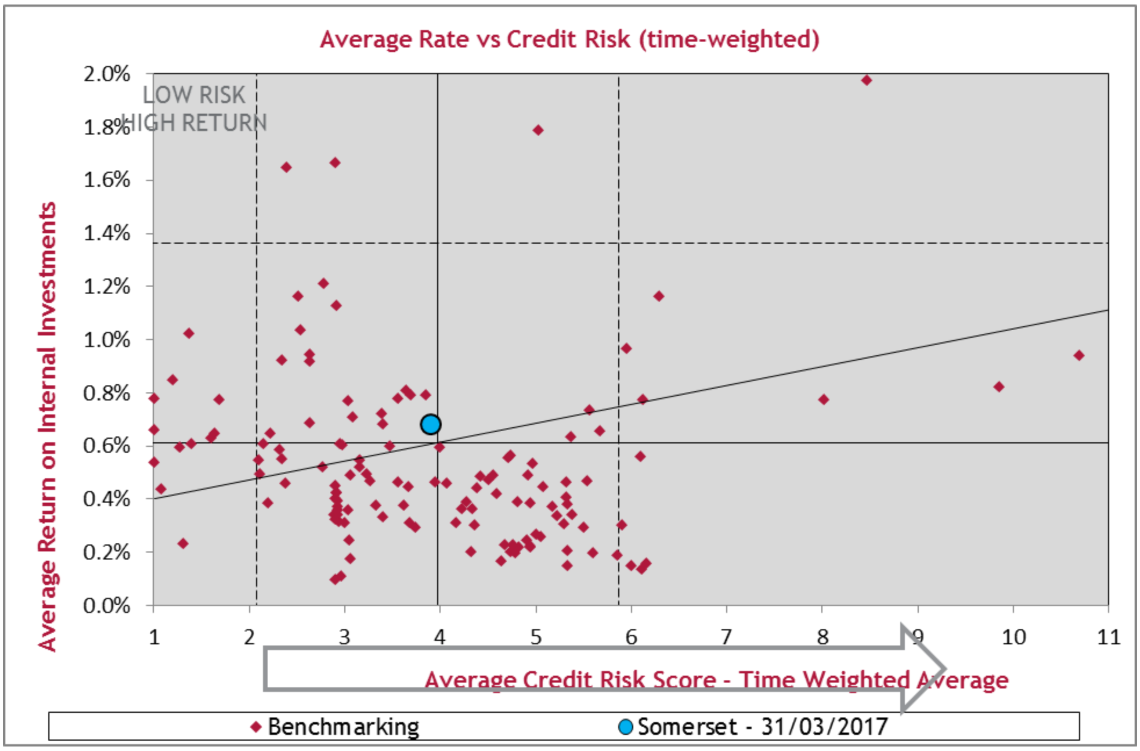
	Average Rate		Average Balance	
	SCC	Others	SCC	Others
June 2015	0.83%	0.69%	£299m	£65m
September 2015	0.73%	0.60%	£282m	£64m
December 2015	0.69%	0.52%	£242m	£62m
March 2016	0.68%	0.61%	£218m	£55m
Average	**0.73%**	**0.61%**	**£260m**	**£62m**

Using this methodology, SCC performance has been above that of comparators. This has been achieved with an average investment balance of more than 4 times that of the average for the universe.

From a risk perspective, both SCC and Other Authorities' average credit rating score was AA- throughout the year. (To give this some perspective, the United Kingdom Government is rated one notch above at AA). The performance relative to risk can be seen in the two graphs below.



It can be seen in both graphs that SCC performance is above the average rate of return whilst being below the average credit risk score.



Security and liquidity have been achieved while returning an overall rate in excess of average rates for all periods up to 1 year (see table 2 above), on a portfolio with an average duration of less than 6 months. Performance was ahead of the Arlingclose comparison group.

The overall return has produced a total income of £2.08m, down by £280,000 from 2015-16 on much reduced balances and rates. If balances had been invested in the relatively risk-free Government Debt Management Account Deposit Facility (DMADF) run by the Debt Management Office (DMO), at 6-month rates, the return would have averaged approximately 0.13%, or £371k, a reduction in income of £1,705,000.

All treasury management activities have not only mitigated risk to SCC to permit the achievement of objectives, but have brought in income and benefits of approximately £206,000.

Icelandic Investments Update

As has been previously reported, SCC in common with 126 other Local Authorities (44% of County Councils and 24% of District Councils), numerous charities, banks, and building societies, and the Audit Commission, had deposits with two Icelandic banks, Glitnir and Landsbanki, at the time the Icelandic Government repatriated their overseas assets, and also in the UK subsidiary of another, Kaupthing Singer & Friedlander (KSF), when the UK FSA placed it into administration.

The current position is this: -

Landsbanki & Glitnir – As reported in the end of 2015-16 Treasury Management Outturn Report, SCC has concluded any interest that it had with these two banks.

Kaupthing, Singer & Friedlander – The estimated range for total dividends was increased at the lower end in the Administrator's October 2016 report, and is now at 86p-86.5p in the pound.

A further dividend of £51,574.66 was received in November 2016. Future dividends will be paid subject to consultation with the Creditors' Committee, and when the level of distributable funds makes it cost effective to do so.

In total, as at 31st March 2017 £23,086,582.66 had been recovered. The shortfall of £1.91m from the original investment was written off back in 2008-09.

Appendix H

Prudential Indicators

Prudential Indicators are agreed and set by Council prior to each financial year. The key objectives are to ensure, within a clear framework, that the Capital Investment plans of the Council are affordable, prudent, and sustainable.

The indicators are regularly monitored, with actuals reported to the Director of Finance & Performance monthly.

The Council can confirm that it has complied with its Prudential Indicators for 2016-17, with the exception of one band within the Maturity Structure of Borrowing Indicator. This is a technical breach as it was not due to Treasury activity, but was due to the fact that the £57.5m of Barclays LOBOs have become fixed-term loans. Prudential guidance treats this differently, and the loans have moved between bands intra-year. The higher limit on loans maturing between 30-40 years was set at 20%, but reached 26.3% in June as the £57.5m loans moved to that band. Those indicators agreed by Full Council and actual figures as at 31st March are included below:

Borrowing	**Limit for 2016-17**	**As at 31-03-17**
Authorised Limit	374	340
Operational Boundary	360	340
Upper limit – Fixed Interest	100%	100%
Upper limit – Variable Interest	30%	0%

Maturity Structure of Borrowing	**Upper**	**Lower**	**Actual**
Under 12 months	55%	20%	28.9%
>12 months and within 24 months	20%	0%	0.0%
>24 months and within 5 years	20%	5%	7.4%
>5 years and within 10 years	20%	5%	9.0%
>10 years and within 20 years	20%	5%	12.2%
>20 years and within 30 years	20%	0%	0.0%
>30 years and within 40 years	20%	5%	26.3%
>40 years and within 50 years	25%	5%	16.2%
>50 years and above	10%	0%	0.0%

Limit for Principal sums invested > 364 days £100m **Actual** £45m

Appendix I

Risk Management & Governance

During the year, all Council treasury management policies, practices, and activities remained compliant with all relevant statutes and guidance, namely the CLG investment guidance issued under the Local Government Act 2003, the CIPFA Code of Practice for Treasury Management, and the CIPFA Prudential Code.

The CLG's Guidance on Investments, revised during 2009-10, reiterated security and liquidity as the primary objectives of a prudent investment policy. All lending was compliant with guidance issued by the CLG, with the investment strategy agreed, and activities conducted within the procedures contained in the TMPs.

As required by the CIPFA TM Code, a mid-year review was presented to Full Council in November 2016.

Officers from the Treasury Management team reported debt and investment positions and performance via comprehensive reports at monthly meetings with the Director of Finance & Performance and/or the Strategic Manager (Finance Technical).

All recent audits conducted by the South West Audit Partnership have received a 'Comprehensive' Audit Opinion, the highest rating for its management of risk.

There was no audit during 2016-17, so the Audit report dated 28th September 2015 was the last one. It awarded the best possible outcome, as quoted below.

> "I am able to offer substantial assurance as the areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed".

The audit was also complimentary regarding policy, procedures and processes, as per the quoted passages below.

> "The procedures for Treasury Management remain unchanged and all key controls assessed during the audit were found to be operating effectively. The Council's Treasury Management Policy, which adopts the key recommendations of CIPFA's Treasury Management in the Public Services Code, is robust and the low risk managed approach continues to be of benefit to the Council".
>
> "In addition, it has been established that all recommendations made in the last review have been actioned. As a result, no recommendations have been made in this report. All Council officers involved in this audit were found to be open and transparent, committed to further improvement and receptive to feedback".

Arlingclose have been retained Treasury Advisors throughout the period.

During the year Treasury staff have continued to attend regular courses and seminars provided through the CIPFA Treasury Management Network (TMN), its advisors, Arlingclose, and other ad hoc events including treasury software supplier forums.