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 late December 2017.

- 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 late December 2017.

- Under the Act the Ministry for Housing, Communities and Local Government (MHCLG) has issued Investment Guidance to structure and regulate the Council's investment activities. This was updated in February 2018, effective from 1st April 2018.

Treasury Management Policy Statement

Introduction and Background

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.

Policies and Objectives of Treasury Management Activities

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

Statistical Reporting 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 become more 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 2017-18 including Market and PWLB Rates

The UK economy showed signs of slowing with March 2018 estimates showing GDP growing by 1.8% in 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016. As well as domestic resilience, growth also reflected the re-emergence of the Eurozone economies and an increasingly buoyant US economy.

The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November 2017 before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth turned negative, before slowly recovering as inflation subsided.

The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit.

The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC only reversed its August 2016 cut following the referendum result. The February 2018 Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. In March however, two MPC members voted to increase policy rates immediately and the minutes of the meeting suggested that an increase in May 2018 was highly likely. Markets built in a probability of 90% for a May hike, although recent weak economic data has seen the MPC keep rates at 0.5% at the May meeting. Market rates have oscillated in tandem with prevailing sentiment.

The FTSE 100 had a strong finish to 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

In contrast to the UK, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an 'easing bias' in its market communications, the central bank appeared some way off normalising interest rates. The US economy grew steadily and increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Fed is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war.

Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June 2017 rose to 1.65% by the end of March 2018. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-

end. 20-year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

The November 2017 increase in Bank Rate, which had barely been indicated in previous bank 'forward guidance' and was not expected by the market, nonetheless resulted in proportionately higher money markets rates. The accompanying minutes suggested future rises 'of gradual pace and to a limited extent'. However, it was after the February meeting that rates rose significantly higher during the last 6-weeks of the year. Where previously a rise had been priced in for the second half of 2018, most economists had thought a May hike was nailed-on. Rates responded accordingly and movements can be seen in the LIBID table below. 1-month, 3-month, 6-month and 12-month LIBID rates averaged 0.23%, 0.28%, 0.40% and 0.60% respectively for 2017-18, and at 31st March 2018 were 0.39%, 0.59%, 0.70% and 0.88%.

A summary of LIBID benchmark and PWLB rates is included below.

Money Market Rates 2017-18 (LIBID Source = ICE LIBOR previously BBA LIBOR)

	O/N LIBID	7-Day LIBID	1-Month LIBID	3-Month LIBID	6-Month LIBID	12-Month LIBID	2-Yr SWAP
01/04/2017	0.10	0.11	0.13	0.21	0.37	0.59	0.62
30/04/2017	0.10	0.11	0.13	0.20	0.35	0.55	0.56
31/05/2017	0.10	0.11	0.13	0.17	0.31	0.51	0.52
30/06/2017	0.09	0.11	0.13	0.18	0.34	0.56	0.69
31/07/2017	0.10	0.12	0.13	0.16	0.30	0.50	0.60
31/08/2017	0.10	0.11	0.13	0.15	0.28	0.47	0.53
30/09/2017	0.10	0.11	0.13	0.21	0.37	0.60	0.80
31/10/2017	0.10	0.22	0.28	0.31	0.44	0.65	0.84
30/11/2017	0.35	0.36	0.37	0.40	0.47	0.66	0.86
31/12/2017	0.34	0.36	0.37	0.40	0.45	0.64	0.78
31/01/2018	0.35	0.36	0.37	0.40	0.48	0.68	0.96
28/02/2018	0.35	0.36	0.37	0.46	0.57	0.78	1.03
31/03/2018	0.35	0.36	0.39	0.59	0.70	0.88	1.12
Minimum	0.09	0.11	0.12	0.15	0.27	0.46	0.44
Average 2017-18	**0.20**	**0.21**	**0.23**	**0.28**	**0.40**	**0.60**	**0.73**
Maximum	0.35	0.37	0.39	0.59	0.7	0.88	1.13
Spread	0.26	0.26	0.27	0.44	0.43	0.42	0.69
Average 2016-17	**0.19**	**0.20**	**0.22**	**0.32**	**0.46**	**0.70**	**0.61**
Difference in average	**+0.01**	**+0.01**	**+0.01**	**-0.04**	**-0.06**	**-0.10**	**+0.12**

PWLB Rates 2017-18 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	10 Year EIP	30 Year	50 Year
03/04/2017	1.05	1.45	1.18	2.13	1.49	2.78	2.57
30/04/2017	1.02	1.43	1.15	2.11	1.47	2.79	2.57
31/05/2017	1.05	1.37	1.13	2.02	1.40	2.70	2.48
30/06/2017	1.27	1.63	1.39	2.26	1.66	2.89	2.66
31/07/2017	1.18	1.54	1.28	2.22	1.58	2.88	2.67
31/08/2017	1.10	1.42	1.19	2.06	1.46	2.74	2.52
30/09/2017	1.34	1.79	1.51	2.38	1.82	2.95	2.72
31/10/2017	1.37	1.79	1.53	2.37	1.82	2.92	2.68
30/11/2017	1.43	1.86	1.60	2.40	1.89	2.93	2.69
31/12/2017	1.36	1.76	1.52	2.26	1.79	2.81	2.58
31/01/2018	1.53	2.02	1.76	2.50	2.05	2.91	2.66
28/02/2018	1.58	2.10	1.83	2.57	2.13	2.92	2.66
31/03/2018	1.67	2.05	1.85	2.43	2.07	2.73	2.73
Minimum	1.00	1.34	1.12	1.98	1.37	2.68	2.45
Average 2017-18	**1.31**	**1.70**	**1.45**	**2.28**	**1.73**	**2.85**	**2.61**
Maximum	1.71	2.21	1.97	2.73	2.24	3.08	2.84
Spread	0.71	0.87	0.85	0.75	0.87	0.40	0.39
Average 2016-17	**1.13**	**1.56**	**1.28**	**2.21**	**1.60**	**2.89**	**2.69**
Difference in average	**+0.18**	**+0.14**	**+0.17**	**+0.07**	**+0.13**	**-0.04**	**-0.08**

Appendix D

The Portfolio Position as at 31st March 2018 and a comparison with 2017 are set out below: -

	31st March 2017 £m	31st March 2018 £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 / SWC	0.00	0.22	+0.22
Organisations in the Comfund	9.64	8.36	-1.28
LEP	42.50	49.80	+7.30
Total	**52.14**	**58.38**	**+6.24**
Lending/Investments			
Revenue Lending	7.86	16.89	+9.03
Rate (%)	0.35	0.49	+0.14
Comfund Investment	211.31	179.68	-31.63
Rate (%)	0.69	0.69	0.00
CCLA Property Fund (Nominal)	0.00	10.00	+10.00
Rate (%)	N/A	4.22	+4.22
Total Lending	**219.17**	**206.57**	**-12.60**
Rate (%)	**0.68**	**0.84**	**+0.16**

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 2017 to 2020. All Capital projects were to be funded from Capital Receipts and Grant allowances from central Government, thereby eliminating the need to borrow for 2017-18.

During 2017-18, 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 South West Councils (SWC). 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 SWC 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 2017-18, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. A grant of £36.6m was received on 11th April 2017.

Revenue balances held on behalf of others at year-end increased from £0.0m to £0.22m. Investment in the Comfund by external bodies decreased slightly, from £9.64m to £8.36m, but an increase in LEP monies meant that £58.4m was managed on behalf of others at year-end 2018, an increase of £6.2m.

The Comfund investment of £179.68m was £31.63m lower, whilst revenue lending was £9.03m higher. During the year £10m was invested in the CCLA (Churches, Charities, Local Authorities) Property Fund.

Total lending as at 31st March 2018, including unspent LEP money, stood at over £206m, a decrease of £12.6m from 2017.

Appendix E

Temporary Borrowing

There were no temporary loans taken during 2017-18.

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 caused by Brexit, uncertainty over US trade sanctions, and concerns over Russian, North Korean aggression). 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 higher than in March 2017, a reversal of three years of reducing yields. However, up until early September many maturity rates were lower than the beginning of the financial year. The bank rate rise in November, and market expectation of 'more and sooner' rises from January saw rates increase significantly in early 2018. Differences between the year-end rates and year averages highlight this. 1-year, 5-year, 10-year and 50-year maturity rates averaged 1.31%, 1.70%, 2.28% and 2.61% respectively for 2017-18, and at 31st March 2018 were 1.67%, 2.05%, 2.43% and 2.73%.

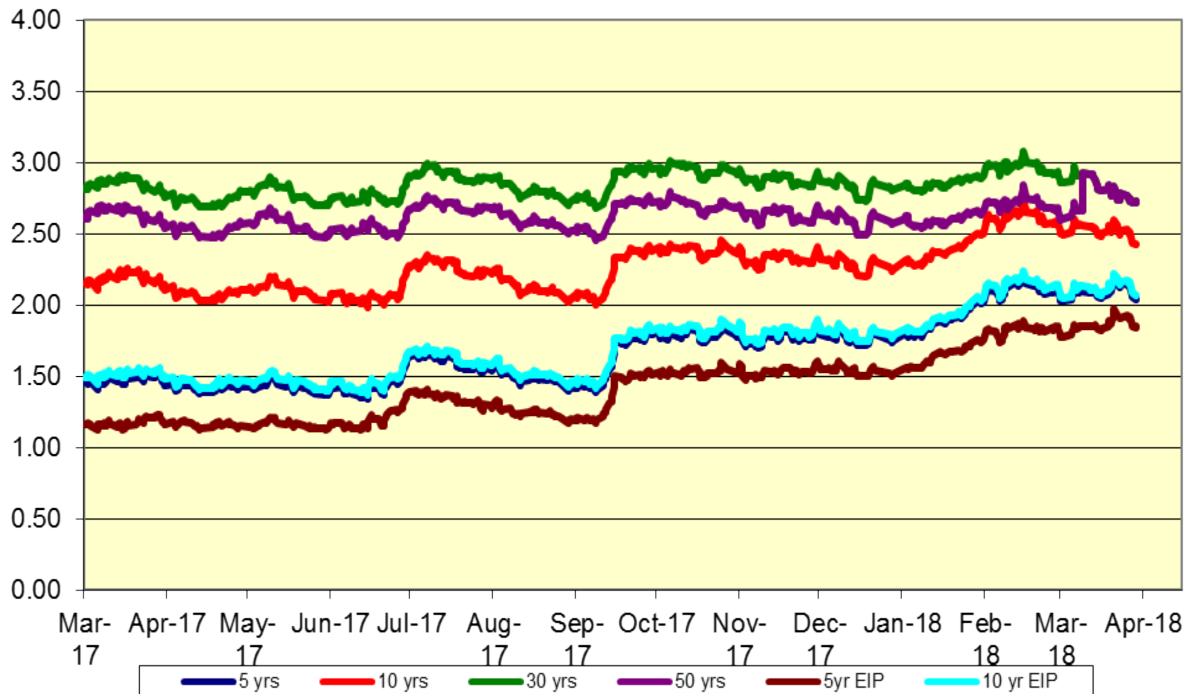
Spreads across all shorter maturities were particularly volatile, the five-year Maturity rate showing a maximum of 2.21% and a minimum of 1.34%, and the 10-year Maturity rate a maximum of 2.73% and a minimum of 1.98%, producing volatile spreads of 0.87% and 0.75% respectively during the year.

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, to £79m by the end of March 2016 and further to £103m at March 2017. During 2017-18 with yields falling further, a year-high premium of £104m would have been payable in June, ending the year in March at £99m. 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 2017-18 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	10 Year EIP	30 Year	50 Year
03/04/2017	1.05	1.45	1.18	2.13	1.49	2.78	2.57
30/04/2017	1.02	1.43	1.15	2.11	1.47	2.79	2.57
31/05/2017	1.05	1.37	1.13	2.02	1.40	2.70	2.48
30/06/2017	1.27	1.63	1.39	2.26	1.66	2.89	2.66
31/07/2017	1.18	1.54	1.28	2.22	1.58	2.88	2.67
31/08/2017	1.10	1.42	1.19	2.06	1.46	2.74	2.52
30/09/2017	1.34	1.79	1.51	2.38	1.82	2.95	2.72
31/10/2017	1.37	1.79	1.53	2.37	1.82	2.92	2.68
30/11/2017	1.43	1.86	1.60	2.40	1.89	2.93	2.69
31/12/2017	1.36	1.76	1.52	2.26	1.79	2.81	2.58
31/01/2018	1.53	2.02	1.76	2.50	2.05	2.91	2.66
28/02/2018	1.58	2.10	1.83	2.57	2.13	2.92	2.66
31/03/2018	1.67	2.05	1.85	2.43	2.07	2.73	2.73
Minimum	1.00	1.34	1.12	1.98	1.37	2.68	2.45
Average 2017-18	**1.31**	**1.70**	**1.45**	**2.28**	**1.73**	**2.85**	**2.61**
Maximum	1.71	2.21	1.97	2.73	2.24	3.08	2.84
Spread	0.71	0.87	0.85	0.75	0.87	0.40	0.39
Average 2016-17	**1.13**	**1.56**	**1.28**	**2.21**	**1.60**	**2.89**	**2.69**
Difference in average	**+0.18**	**+0.14**	**+0.17**	**+0.07**	**+0.13**	**-0.04**	**-0.08**



During 2017-18, 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 £113m of loans that are LOBO loans (Lender's Option Borrower's Option) of which all but £25m were in their option state during 2017-18. None of the lenders exercised their option to request an increase in the rate applied. As stated in the 2017-18 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.

Note that the £57m of loans with Barclays are now effectively long-term fixed loans after they contractually ceded the right to their options.

The weighted average LOBO/Market Loan 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 33.7 years, whilst the PWLB loans average was 26.2 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	*	Standard Chartered Bank	*
Bank of Scotland	*	Svenska Handelsbanken	
Bank of Montreal	*	Toronto-Dominion Bank	
Bank of Nova Scotia		United Overseas Bank	*
Barclays Bank Plc			
Canadian Imperial Bank of Commerce			
Close Brothers Ltd	*	**Sterling CNAV Money Market Funds**	
Commonwealth Bank of Australia	*	Goldman Sachs MMF	
DBS Bank Ltd	*	Deutsche MMF	
Goldman Sachs International Bank	*	Invesco Aim MMF	*
HSBC Bank	*	Federated Prime MMF	*
Landesbank Hessen-Thuringen	*	JP Morgan MMF	*
Lloyds Bank	*	Insight MMF	*
National Australia Bank		Standard Life MMF	*
National Westminster	*	LGIM MMF	*
Nationwide BS	*	SSGA MMF	*
Nordea Bank			
OP Corporate Bank	*		
Oversea-Chinese Banking Corporation	*	**Other Counterparties**	
Rabobank	*	Other Local Authorities	* (18)
Royal Bank of Scotland		Debt Management Office	
Santander UK	*	CCLA Property Fund	*

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.

The rules for UK banks' ring-fencing were finalised by the Prudential Regulation Authority and banks began the complex implementation process ahead of the statutory deadline of 1st January 2019.

Moody's downgraded the UK sovereign rating in September from Aa1 to Aa2 bringing it in line with the other two rating agencies. Moody's also downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 and placed UK banks' long-term ratings on review to reflect the impending ring-fencing of retail activity from investment banking (Barclays, HSBC and RBS were on review for downgrade; Lloyds Bank, Bank of Scotland and National Westminster Bank were placed on review for upgrade). Moody's downgraded Rabobank's long-term rating due to its view on the bank's profitability and the long-term ratings of the major Canadian banks on the expectation of a more challenging operating environment. The long-term ratings of the large Australian banks were also downgraded on its view of the rising risks from their exposure to the Australian housing market.

Standard & Poor's (S&P) revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings, reflecting the institutions' resilience, progress in meeting regulatory capital requirements and being better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019. The agency upgraded Barclays Bank's long-term rating to A from A- after the bank announced its plans for its entities post ring-fencing.

Fitch revised the outlook on Nationwide Building Society to negative and later downgraded the institution's long-term ratings due to its reducing buffer of junior debt.

As there was some uncertainty surrounding which UK banking entities the Council would be dealing with once ring-fencing was implemented, and in response to the above, the Council reduced the duration for unsecured investments to UK banks, to a maximum of 6 months and suspended RBS. It also reduced its' duration limits with Canadian Banks to 6-months from 13-

months. Australian Banks already had a limit of 6-months.

In the first quarter of the financial year, UK bank credit default swaps reached three-year lows on the announcement that the Funding for Lending Scheme, which gave banks access to cheaper funding, was being extended to 2018. For the rest of the year, CDS prices remained broadly flat.

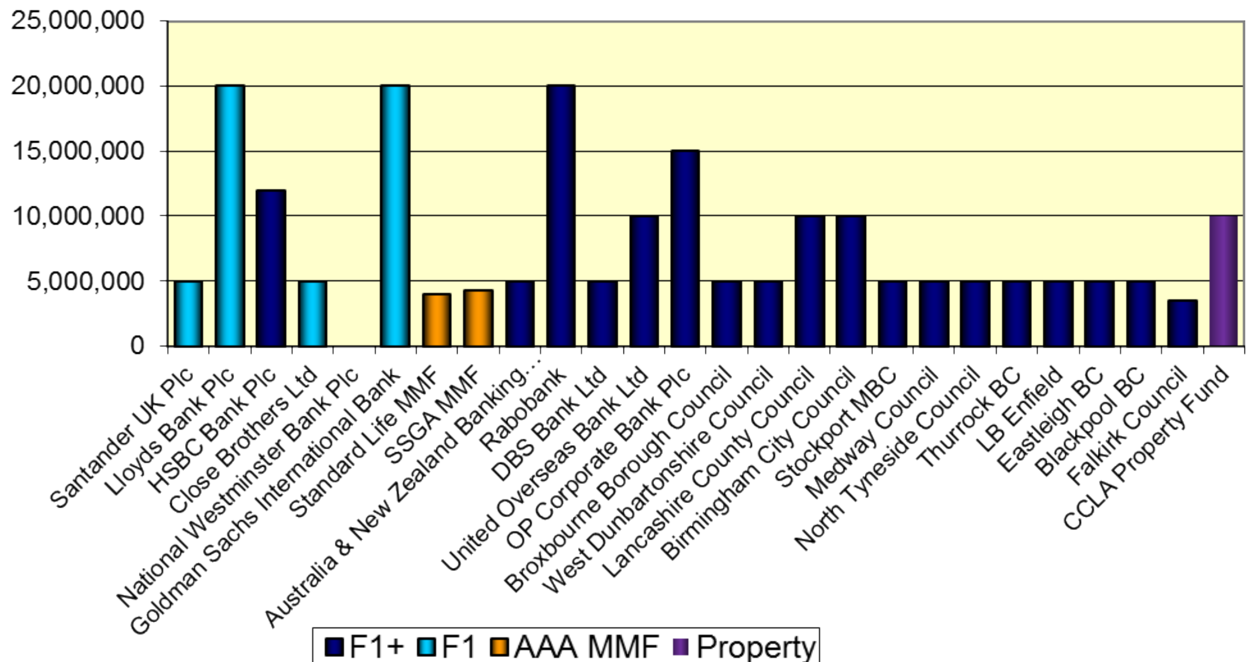
At year-end maximum durations per counterparty were as follows: -

- Nat West– **Operational use only;**
- Barclays, Goldman Sachs International, and Standard Chartered – **100 days;**
- HSBC, Bank of Scotland, Lloyds, Nationwide BS, Santander UK, OP Corporate, Landesbank Hessen-Thuringen and all Australian and Canadian banks – **6-months;**
- Nordea, Rabobank, Svenska Handelsbanken, and all 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 150 days. This peaked in May at 173 days, and ended the year at 136 days as reduced durations took effect. The average Comfund duration for the year was 149 days (163 in 2016-17). This is consistent with the generally accepted outlook for Interest Rates, i.e. to shorten the duration of the portfolio in a rising interest rate environment.

In order to increase diversification of the portfolio, more deposits were placed with UK Local Authorities. Eighteen different Authorities were used during the year. 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 2018.



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.

CCLA Property Fund: In May, the Council placed a £10m investment in the CCLA Property Fund. This Fund has been in existence for more than 25 years and is only available to Local Authorities. It is an actively managed, diversified portfolio of UK Commercial Property with a stated investment objective “to provide investors with a high level of income and long-term capital appreciation”.

The decision to invest in the CCLA Property Fund was driven by 2 key factors. Firstly, by diversifying away from unsecured Bank deposits, it would help to mitigate the increased risk posed by unsecured bank bail-in, and secondly, to mitigate the risk of negative returns (real negative returns, or inflation adjusted returns) posed by the low interest rate environment.

A full risk assessment was undertaken, and identified the main risks as depreciation in market value (there is an instant drop in value due to the bid/offer spread), and loss of liquidity. These are both mitigated by treating the investment as a longer-term hold. By identifying a suitable level of longer-term

investment with reference to core balances and reserves, liquidity will not be compromised, and potential dips in market value can be patiently sat out. Whilst planning for the downside, there is also the upside of expected capital appreciation in the longer-term. In the meantime, the average Property Fund yield of circa 4.46% net, was circa 3.9% above current cash yields, and provided approximately £325,000 of extra income during the year.

Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. The November increase in Bank Rate had not been expected by the market as rates for the first half of the year remained minimal. The minutes of the November 2017 meeting suggested future rate rises 'of gradual pace and to a limited extent'. However, it was after the February 2018 meeting that rates rose proportionately higher during the last 6-weeks of the year. 1-month, 3-month, 6-month and 12-month LIBID rates averaged 0.23%, 0.28%, 0.40% and 0.60% respectively for 2017-18, and at 31st March 2018 were 0.39%, 0.59%, 0.70% and 0.88%. Despite the actual and anticipated rate rises during the year, the 2017-18 average rates for 3-month, 6-month and 12-month LIBID were 0.04%, 0.06%, and 0.10% basis points below those for 2016-17. A table of rates is shown below.

Money Market Rates 2017-18 (LIBID Source = ICE LIBOR previously BBA LIBOR)

	O/N LIBID	7-Day LIBID	1-Month LIBID	3-Month LIBID	6-Month LIBID	12-Month LIBID	2-Yr SWAP
01/04/2017	0.10	0.11	0.13	0.21	0.37	0.59	0.62
30/04/2017	0.10	0.11	0.13	0.20	0.35	0.55	0.56
31/05/2017	0.10	0.11	0.13	0.17	0.31	0.51	0.52
30/06/2017	0.09	0.11	0.13	0.18	0.34	0.56	0.69
31/07/2017	0.10	0.12	0.13	0.16	0.30	0.50	0.60
31/08/2017	0.10	0.11	0.13	0.15	0.28	0.47	0.53
30/09/2017	0.10	0.11	0.13	0.21	0.37	0.60	0.80
31/10/2017	0.10	0.22	0.28	0.31	0.44	0.65	0.84
30/11/2017	0.35	0.36	0.37	0.40	0.47	0.66	0.86
31/12/2017	0.34	0.36	0.37	0.40	0.45	0.64	0.78
31/01/2018	0.35	0.36	0.37	0.40	0.48	0.68	0.96
28/02/2018	0.35	0.36	0.37	0.46	0.57	0.78	1.03
31/03/2018	0.35	0.36	0.39	0.59	0.70	0.88	1.12
Minimum	0.09	0.11	0.12	0.15	0.27	0.46	0.44
Average 2017-18	**0.20**	**0.21**	**0.23**	**0.28**	**0.40**	**0.60**	**0.73**
Maximum	0.35	0.37	0.39	0.59	0.7	0.88	1.13
Spread	0.26	0.26	0.27	0.44	0.43	0.42	0.69
Average 2016-17	**0.19**	**0.20**	**0.22**	**0.32**	**0.46**	**0.70**	**0.61**
Difference in average	**+0.01**	**+0.01**	**+0.01**	**-0.04**	**-0.06**	**-0.10**	**+0.12**

Comfund

Comfund investment decreased to £179.68m at year-end 2018, by £31.63m from the £211.31m at year-end 2017.

The total of other investors' balances also decreased slightly by £1.28m.

The average balance of the Comfund throughout 2017-18 was £207m, a £43m decrease on the previous years' average.

The Comfund vehicle, with an annual return of 0.60% out-performed the benchmark for the year, by 0.27%.

A total of approximately £1.24m was earned in interest in the year, a decrease of £686,000 on the figure for 2016-17 of £1.93m, largely due to reduced balances of £43m, subdued rates, and a reduction in investment duration.

Comfund administration charges received from investors totalled approximately £24,860 for the year.

Revenue

Revenue balances averaged £33.3m during the year, with an average yield of 0.33%. 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 0.21%. This income stream earned interest of over £110,000.

Property Fund

An investment of £10m was made in the CCLA Property Fund on 31st May 2017. To 31st March it delivered an average net income yield of 4.46%, and £371,841 cash.

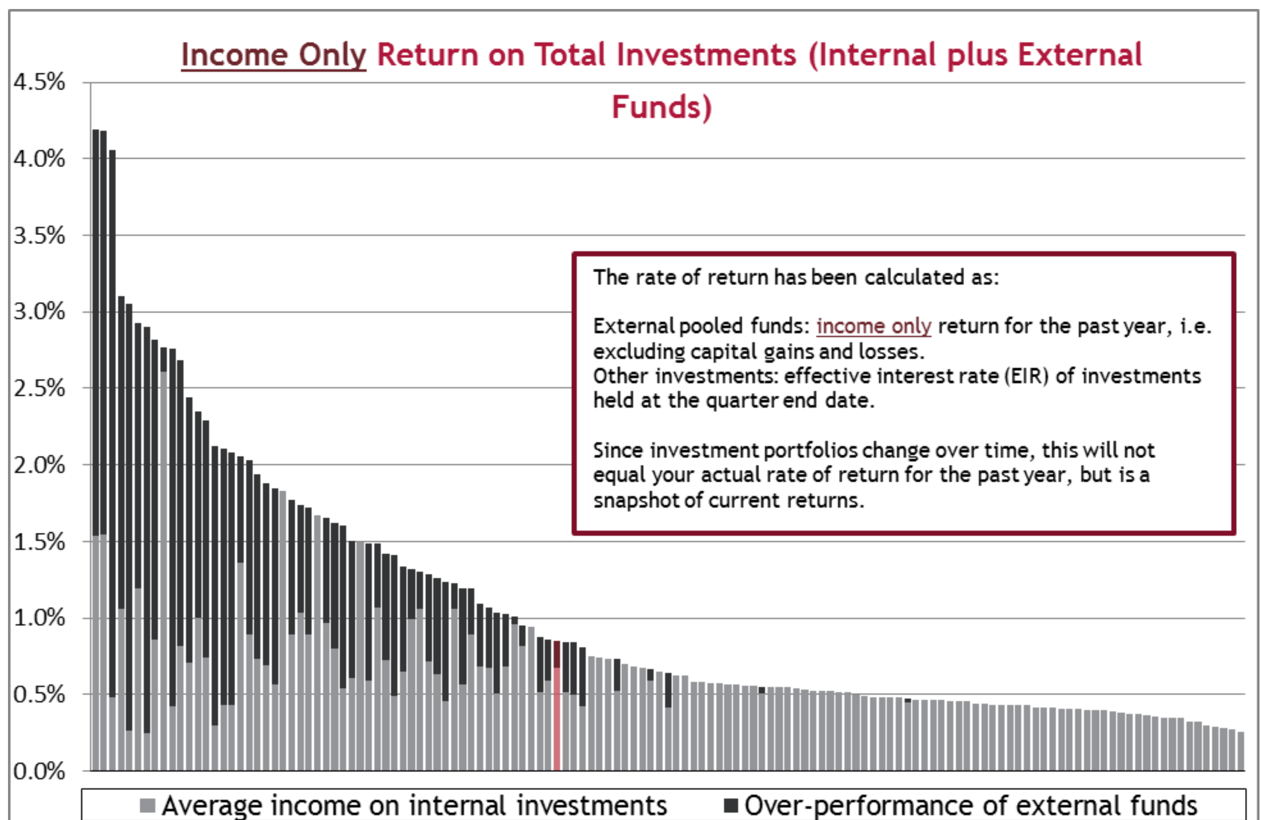
Combined

The combined average daily balance of the Council's investments during 2017-18 was £249.1m against £285.4m for 2016-17. The overall weighted investment return of combined investments was 0.69% against a return of 0.72% for 2016-17.

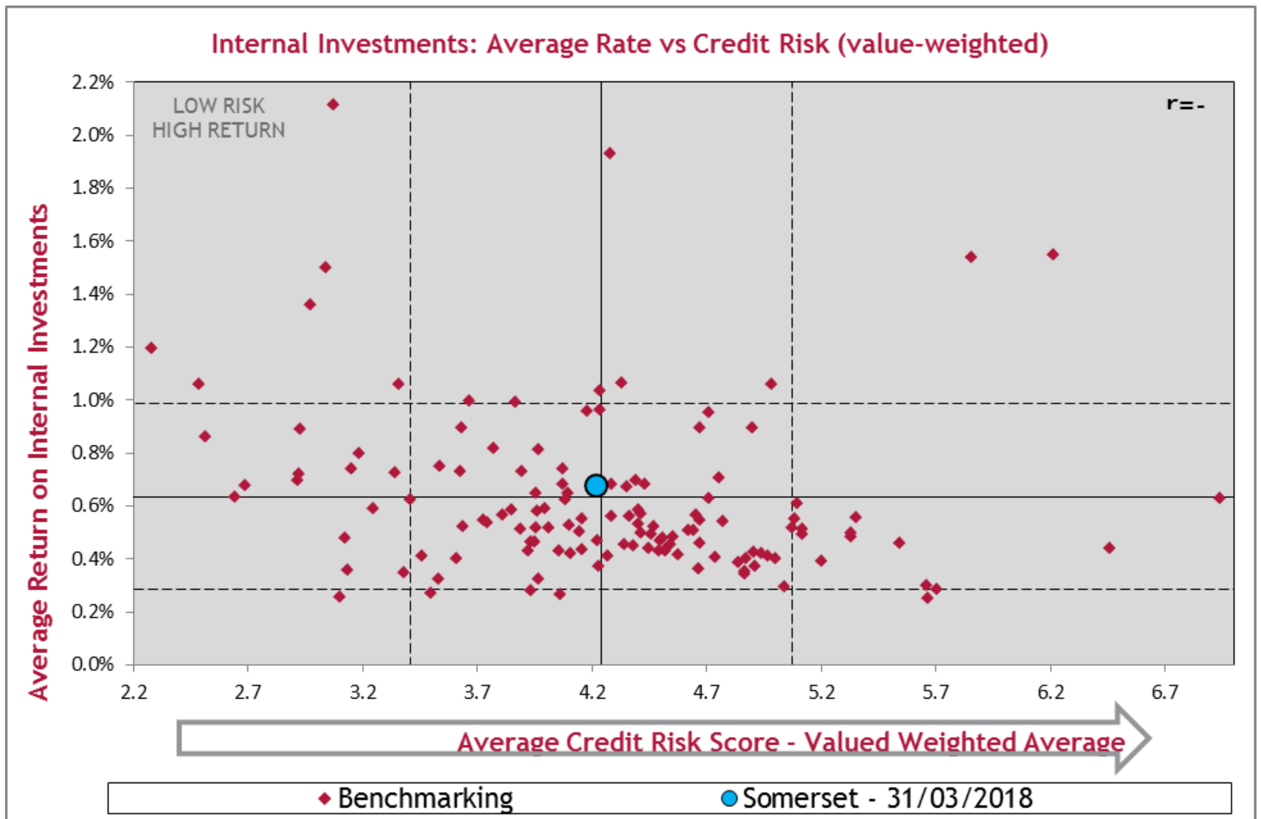
2017-18 was the ninth complete year that SCC had the services of retained Treasury advisors, Arlingclose. It would therefore seem appropriate to look at SCC performance compared with other Authorities that use Arlingclose, i.e. that share much of the same investment advice, particularly regarding counterparties. However, many of the caveats mentioned in appendix B may apply. 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 2017	0.53%	0.51%	£258m	£70m
September 2017	0.53%	0.48%	£246m	£73m
December 2017	0.60%	0.54%	£218m	£73m
March 2018	0.68%	0.63%	£205m	£67m
Average	**0.59%**	**0.54%**	**£232m**	**£71m**

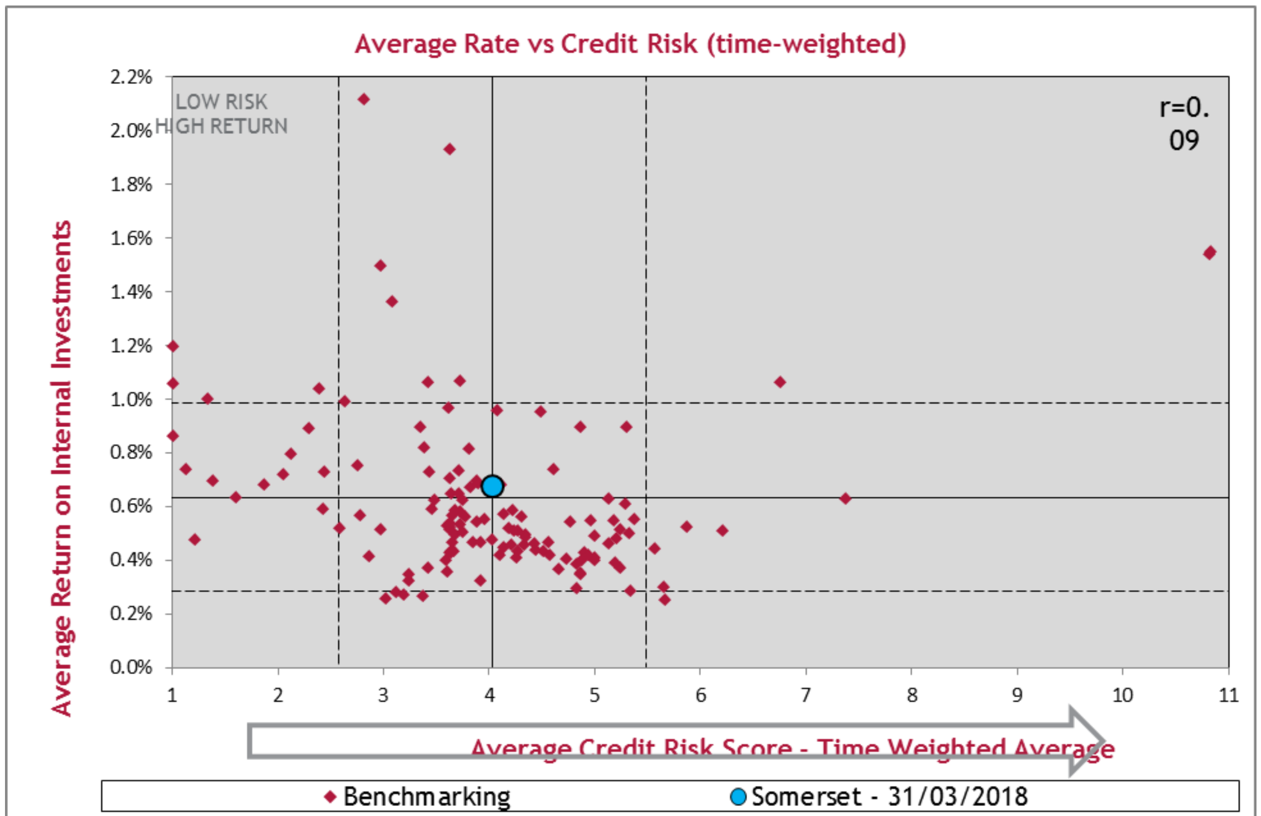
Using this methodology, SCC performance has been above that of comparators. This has been achieved with an average investment balance of more than 3 times that of the average for the universe. Returns as at 31st March 2018, including esoteric investments can be seen in the graph below (If in black & white, SCC is the bar above the 1st 'e' in investments).



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). When comparing the average days to maturity with that of other County Councils, the SCC average of 116 days is a full **2 years** below the 879 days for other County Councils. This in part reflects the fact that SCC is holding approximately £50m of LEP money on behalf of its partners, so needs to retain more liquidity, and that a much more cautious approach is taken with regard to interest rate risk, i.e. more funds are available sooner to invest in an anticipated rising rate market. 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 above), on a portfolio with an average duration of less than 5 months. Performance was ahead of the Arlingclose comparison group for internally managed investments.

The overall return has produced a total income of £1.73m, down by £350,000 from 2016-17 on much reduced balances and lower 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 0.16%, or £399k, a reduction in income of £1,330,000.

All treasury management activities have not only mitigated risk to SCC to permit the achievement of objectives, and including a fee for the management of the LEP money, have brought in income and benefits of approximately £204,000.

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 2016-17 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 remains at 86p-86.5p in the pound.

Two further dividends have been received during 2017-18, £92,834.38 on 4th May 2017 and £36,102.26 on 12th December 2017. 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 2018 £23,215,519.30 had been recovered. The shortfall of £1.78m 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 2017-18. Those indicators agreed by Full Council and actual figures as at 31st March are included below:

Borrowing	Limit for 2017-18	As at 31-03-18
Authorised Limit	389	340
Operational Boundary	363	340
Upper limit – Fixed Interest	100%	100%
Upper limit – Variable Interest	30%	0%

Maturity Structure of Borrowing	Upper	Lower	Actual
Under 12 months	45%	15%	28.6%
>12 months and within 24 months	20%	0%	7.4%
>24 months and within 5 years	20%	0%	0.0%
>5 years and within 10 years	20%	5%	10.7%
>10 years and within 20 years	20%	5%	10.6%
>20 years and within 30 years	20%	0%	0.0%
>30 years and within 40 years	35%	5%	29.4%
>40 years and within 50 years	20%	5%	13.3%
>50 years and above	5%	0%	0.0%

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

Appendix I

Non-Financial Assets, Regulatory Changes, Risk Management & Governance

Some Local Authorities have been investing in non-financial assets, with the primary aim of generating profit. Others have entered into very long-term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects. Some recent 'non-financial investments' by other Local Authorities are highlighted in Appendix B.

The National Audit Office and the Public Accounts Committee raised a number of concerns about Local Authority (investment) behaviour. These are: -

- Local Authorities are exposing themselves to too much financial risk through borrowing and investment decisions
- There is not enough transparency to understand the exposure that LA's have as a result of borrowing and investment decisions
- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving

As a result of esoteric investments, and the subsequent review, Statutory Guidance on Local Government Investments has been revised, effective 1st April 2018. The CIPFA Treasury Management and Prudential Codes have also been reviewed and updated.

Whilst SCC does not currently, and has no immediate plans to 'invest' in esoteric schemes, it is appropriate to highlight the main thrust of changes introduced.

<u>Revised CIPFA Codes</u>

CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code are being incorporated into Treasury Management Strategies and monitoring reports.

The revised Prudential Code introduces the requirement for a Capital Strategy which provides a high-level overview of the long-term context of capital expenditure and investment decisions and their associated risks and rewards, along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced and approved by Full Council, the determination of the Treasury Management Strategy can be delegated to a committee. The Code also expands on the process and governance issues of capital expenditure and investment decisions.

In the revised Treasury Management Code the definition of 'investments' has been widened to include non-financial assets held primarily for financial returns such as investment property, as well as financial assets. These, along with

other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is be identified and reported.

MHCLG Investment Guidance and Minimum Revenue Provision (MRP)

In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Guidance on Local Government Investments and Statutory Guidance on Minimum Revenue Provision (MRP). Changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called “loans” (e.g. temporary transfer of cash to a third party, joint venture, subsidiary or associate). The Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies must detail the extent to which service delivery objectives are reliant on investment income and a contingency plan should yields on investments fall.

The definition of prudent MRP has been changed to “put aside revenue over time to cover the CFR”; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

MiFID II

As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could “opt up” to professional client status, providing certain criteria was met. This included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year’s relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Council has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

Risk Management, Governance, and Compliance

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 reiterates 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 2017.

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 2017-18, so the Audit report dated 28th September 2015 remains 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.