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

<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 Chief Finance Officer 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

Statistical Reporting Limitations

SCC no longer subscribes to the CIPFA Treasury Management Benchmarking Club. CIPFA Treasury Management Benchmarking Club produced detailed reports of Local Authority performance, and also compared 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.

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.

Appendix C

The Economy and Events in 2018-19 including Market and PWLB Rates

UK GDP rose to 0.6% in the third calendar quarter from 0.4% in the second, but fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend.

After spiking at over $85 a barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year on year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report.

Labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With 29th March 2019, the original EU 'exit day' now been and gone, an extension to the Brexit process has been agreed. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. Whilst the EU insists that the terms of the deal are not up for further negotiation, the ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with the EU. The EU itself appeared to show signs of a rapid slowdown in economic growth with Germany and France both suffering downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets: December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year. The 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The August increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3-month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

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

Money Market Rates 2018-19 (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
01/04/2018	0.35	0.36	0.39	0.59	0.70	0.88	1.10
30/04/2018	0.35	0.37	0.39	0.59	0.68	0.85	1.05
31/05/2018	0.35	0.36	0.37	0.49	0.59	0.76	0.93
30/06/2018	0.34	0.36	0.38	0.55	0.66	0.84	1.01
31/07/2018	0.33	0.50	0.56	0.67	0.78	0.93	1.11
31/08/2018	0.58	0.58	0.60	0.68	0.77	0.92	1.10

30/09/2018	0.58	0.59	0.60	0.68	0.78	0.94	1.14
31/10/2018	0.57	0.59	0.60	0.69	0.80	0.93	1.12
30/11/2018	0.56	0.58	0.61	0.77	0.89	1.01	1.17
31/12/2018	0.55	0.58	0.61	0.79	0.91	1.05	1.16
31/01/2019	0.55	0.58	0.61	0.79	0.90	1.04	1.09
28/02/2019	0.55	0.57	0.60	0.73	0.87	1.01	1.10
31/03/2019	0.55	0.57	0.61	0.72	0.83	0.94	0.96
Average 2018-19	**0.49**	**0.51**	**0.53**	**0.67**	**0.79**	**0.94**	**1.09**
Minimum	0.33	0.35	0.37	0.48	0.59	0.75	0.89
Maximum	0.58	0.59	0.61	0.81	0.92	1.06	1.23
Spread	0.25	0.24	0.24	0.33	0.33	0.31	0.34
Average 2017-18	**0.20**	**0.21**	**0.23**	**0.28**	**0.40**	**0.60**	**0.73**
Difference in average	**+0.29**	**+0.30**	**+0.30**	**+0.29**	**+0.39**	**+0.34**	**+0.36**

PWLB Rates 2018-19 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	15 Year EIP	30 Year	50 Year
03/04/2018	1.68	2.04	1.84	2.42	2.26	2.71	2.47
30/04/2018	1.63	2.06	1.82	2.51	2.33	2.86	2.63
31/05/2018	1.50	1.91	1.68	2.36	2.18	2.72	2.49
30/06/2018	1.60	1.97	1.75	2.38	2.21	2.74	2.55
31/07/2018	1.66	2.04	1.82	2.44	2.28	2.80	2.61
31/08/2018	1.69	2.03	1.82	2.42	2.26	2.80	2.62
30/09/2018	1.75	2.13	1.91	2.53	2.37	2.91	2.76
31/10/2018	1.72	2.01	1.82	2.42	2.24	2.87	2.75
30/11/2018	1.73	1.93	1.79	2.35	2.15	3.06	2.94
31/12/2018	1.73	1.90	1.78	2.28	2.10	2.82	2.70
31/01/2019	1.74	1.90	1.78	2.25	2.09	2.74	2.62
28/02/2019	1.79	1.96	1.85	2.30	2.13	2.81	2.69
31/03/2019	1.68	1.75	1.68	2.05	1.90	2.57	2.43
Average 2018-19	**1.70**	**2.00**	**1.81**	**2.39**	**2.22**	**2.82**	**2.66**
Minimum	1.48	1.70	1.63	2.00	1.85	2.50	2.36
Maximum	1.84	2.27	2.02	2.70	2.53	3.10	2.99

Spread	0.36	0.57	0.39	0.70	0.68	0.60	0.63
Average 2017-18	**1.31**	**1.70**	**1.45**	**2.28**	**2.04**	**2.85**	**2.61**
Difference in average	**+0.39**	**+0.30**	**+0.36**	**+0.11**	**+0.18**	**-0.03**	**+0.05**

Appendix D

The Portfolio Position as at 31st March 2019 and a comparison with 2018 are set out below: -

	31st March 2018 £m	31st March 2019 £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	165.5	0.00
Rate (%)	4.72	4.74	+0.02
Sub-total	**329.55**	**324.55**	**-5.00**
Rate (%)	**4.66**	**4.66**	**0.00**
Short-Term Borrowing			
External Borrowing	0.0	0.0	**0.0**
Total Borrowings	**329.55**	**324.55**	**-5.00**
Cash Managed on behalf of others			
ENPA / SWC	0.22	0.11	-0.11
Organisations in the Comfund	8.36	7.48	-0.88
LEP	49.80	35.25	-14.55
Total	**58.38**	**42.84**	**-15.54**
Lending/Investments			
Revenue Lending	16.89	34.93	+18.04
Rate (%)	0.49	0.79	+0.30
Comfund Investment	179.68	151.15	-28.53
Rate (%)	0.69	1.02	+0.33
CCLA Property Fund (Nominal)	10.00	10.00	0.00
Rate (%)	4.22	4.35	+0.13
Total Lending	**206.57**	**196.08**	**-10.49**
Rate (%)	**0.84**	**1.15**	**+0.31**
Note: Figures are subject to rounding			

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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 2018 to 2021. Capital projects identified were to be funded using a combination of grant, capital receipts, and contributions. Although timing of capital expenditure is never totally predictable, it was envisaged that borrowing of up to £40m may have been necessary.
As the differential between investment earnings and debt costs remained negative during 2018-19, a passive borrowing strategy, borrowing funds as they were required was deemed to be most appropriate. With capital spending less than anticipated, no new borrowing was undertaken. The benefits of this strategy were monitored and weighed against the risk of shorter-term rates rising more quickly than expected.

During 2018-19, there were no scheduled debt maturities. The PWLB portfolio remained the same.

In November, the opportunity arose to bid for (and thereby own and terminate) a £5m LOBO. In conjunction with our TM advisors Arlingclose, we were successful in our bid and the loan was prepaid in December. Although a premium of £1.1m was paid, both in-year and long-term revenue savings were achieved, whilst reducing refinancing risk posed by the LOBO.

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 2018-19, SCC was retained to manage the Local Enterprise Partnership (LEP) Growth Deal Grant on behalf of the other Enterprise Partners. A further grant of £10.5m was received on 20th April 2018 and added to the £49.8m already held. £35.25m was held on behalf of the LEP at year-end.

Revenue balances held on behalf of others at year-end decreased from £0.22m to £0.11m. Investment in the Comfund by external bodies decreased slightly, from £8.36m to £7.48m. A smaller grant and an increase in spending by the LEP meant a reduction of £14.5m of that money. £42.84m was managed on behalf of others at year-end 2019, a decrease of £15.54m.

The Comfund investment of £151.15m was £28.53m lower, whilst revenue lending was £18.04m higher due to anticipated cash flow in early April. During the year £10m remained invested in the CCLA (Churches, Charities, Local Authorities) Property Fund.

Total lending as at 31st March 2019, including unspent LEP money, stood at over £196m, a decrease of £10.5m from 2018.

It should be noted that circa £20m of extra grant was received from Central Government during 2018-19.

Appendix E

Temporary Borrowing

There were no temporary loans taken during 2018-19.

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 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 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 lower than in March 2018 (the exception being 1-year which was the same), a reversal of last years' rise in yields. However, up until September many maturity rates were higher than the beginning of the financial year. The bank base rate rise in August and market expectation of 'more and sooner' rises, saw rates increase significantly and peak in the Autumn. The fall in rates at the end of the year were driven by the fear of a no-deal Brexit, as investors clamoured for the safe haven of Gilts. As a result of the above. 1-year, 5-year, 10-year and 50-year maturity rates averaged 1.70%, 2.00%, 2.39% and 2.66% respectively for 2018-19, and at 31st March 2018 were 1.68%, 1.75%, 2.05% and 2.43%.

Spreads across all shorter maturities were particularly volatile, the five-year Maturity rate showing a maximum of 2.27% and a minimum of 1.70%, and the 10-year Maturity rate a maximum of 2.70% and a minimum of 2.00%, producing volatile spreads of 0.57% and 0.70% respectively during the year.

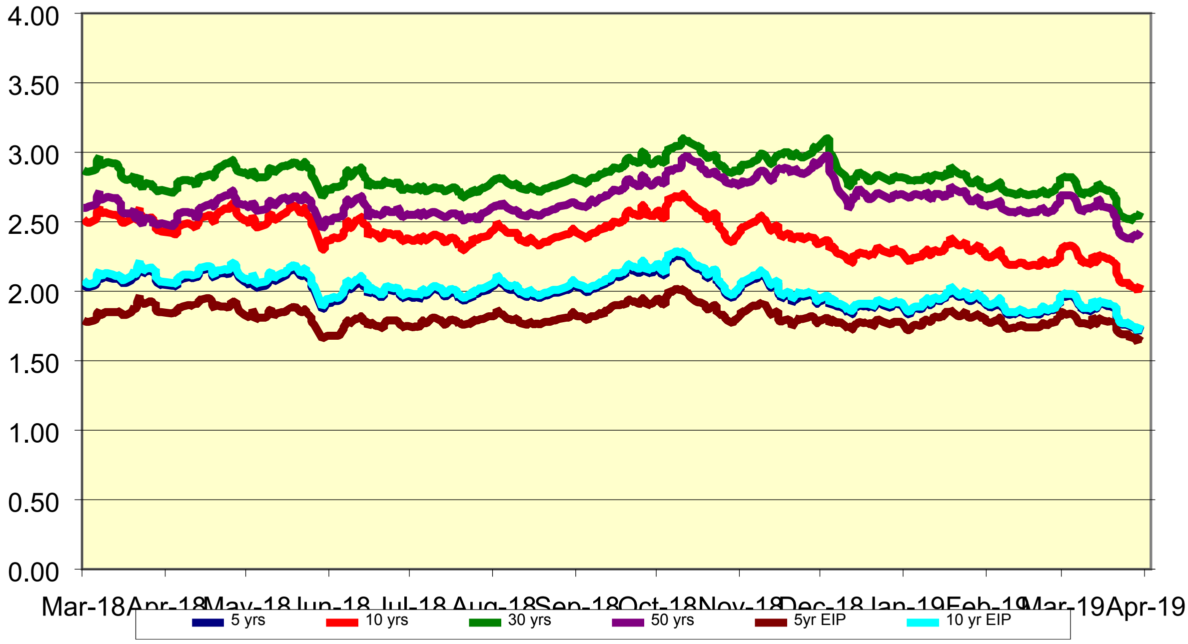
When yields decline, it becomes more expensive to repay debt prematurely. To give an example, to repay the entire PWLB portfolio in March 2014 would have incurred a premium of £33.5m (20% of principal). By March 2016 this had increased to £79m and further to £98.8m at March 2018. During 2018-19 with yields peaking in Autumn, a year-low premium of £83m would have been payable in October, ending the year in March at £102m (64% of principal). 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 2018-19 (Maturity rates unless stated)

	1 Year	5 Year	5 Year EIP	10 Year	15 Year EIP	30 Year	50 Year
03/04/2018	1.68	2.04	1.84	2.42	2.26	2.71	2.47
30/04/2018	1.63	2.06	1.82	2.51	2.33	2.86	2.63
31/05/2018	1.50	1.91	1.68	2.36	2.18	2.72	2.49
30/06/2018	1.60	1.97	1.75	2.38	2.21	2.74	2.55
31/07/2018	1.66	2.04	1.82	2.44	2.28	2.80	2.61
31/08/2018	1.69	2.03	1.82	2.42	2.26	2.80	2.62
30/09/2018	1.75	2.13	1.91	2.53	2.37	2.91	2.76
31/10/2018	1.72	2.01	1.82	2.42	2.24	2.87	2.75
30/11/2018	1.73	1.93	1.79	2.35	2.15	3.06	2.94
31/12/2018	1.73	1.90	1.78	2.28	2.10	2.82	2.70
31/01/2019	1.74	1.90	1.78	2.25	2.09	2.74	2.62
28/02/2019	1.79	1.96	1.85	2.30	2.13	2.81	2.69
31/03/2019	1.68	1.75	1.68	2.05	1.90	2.57	2.43
Average 2018-19	**1.70**	**2.00**	**1.81**	**2.39**	**2.22**	**2.82**	**2.66**
Minimum	1.48	1.70	1.63	2.00	1.85	2.50	2.36
Maximum	1.84	2.27	2.02	2.70	2.53	3.10	2.99
Spread	0.36	0.57	0.39	0.70	0.68	0.60	0.63
Average 2017-18	**1.31**	**1.70**	**1.45**	**2.28**	**2.04**	**2.85**	**2.61**
Difference in average	**+0.39**	**+0.30**	**+0.36**	**+0.11**	**+0.18**	**-0.03**	**+0.05**

Movements in PWLB rates (March 2018 - March 2019)



During 2018-19, 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 2018-19. None of the lenders exercised their option to request an increase in the rate applied. As stated in the 2018-19 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 £57.5m of loans with Barclays are now effectively long-term fixed loans after they contractually ceded the right to their options.

In November, the opportunity arose to bid for (and thereby own and terminate) a £5m LOBO. In conjunction with our TM advisors Arlingclose, we were successful in our bid and the loan was prepaid in December. A premium of £1.1m was paid, 22% of principal. This compares favourably to the 64% for PWLB repayment at year-end. As the premium can be written off over the remaining life of the old loan, both in-year and long-term revenue savings were achieved, whilst reducing refinancing risk posed by the LOBO. New borrowing required to replace the loan, most probably to be taken in 2019-20 will almost certainly be at a much-reduced rate.

The weighted average LOBO/Market Loan rate for SCC for the year was 4.73%.

With limited debt activity during the year, the weighted average term for SCC market loans at 31st March was 33.1 years, whilst the PWLB loans average was 25.2 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	
DZ Bank		Invesco Aim MMF	*
Goldman Sachs International Bank	*	Federated Prime MMF	*
HSBC Bank	*	JP Morgan MMF	
Landesbank Hessen-Thuringen		Insight MMF	*
Lloyds Bank	*	Aberdeen Standard MMF	*
National Australia Bank		LGIM MMF	*
National Westminster	*	SSGA MMF	*
Nationwide BS			
Nordea Bank			
OP Corporate Bank	*		
Oversea-Chinese Banking Corporation		**Other Counterparties**	
Rabobank	*	Other Local Authorities	* (21)

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.

There were few credit rating changes during the period for overseas counterparties, Moody's upgrading the ratings of Canadian banks being the notable change.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities, and the subsequent re-rating by the agencies resulted in some notable changes to the ring-fenced entities. Fitch upgraded Barclays, RBS, Nat West, and Santander UK to A+, RBS and Nat West from BBB+, which was previously below SCC minimum criteria.

Moody's also elevated RBS and Nat West, from A2 to A1, but Barclays went in the opposite direction.

Standard & Poor's upgraded Bank of Scotland and Lloyds to A+ from A, and RBS and Nat West from BBB+ to A-. This put RBS and Nat West above minimum criteria across the 3 agencies and made them eligible for consideration for investments.

As a result of the continued uncertainty around Brexit, Fitch has put the United Kingdom Government and most UK domiciled banks on Ratings Watch, citing an increased risk of a disruptive 'no-deal' Brexit.

Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

In response to the above, the Council reintroduced RBS and Nat West onto the lending list. Nordea Bank and Rabobank were reduced to 6-months, leaving the 3 Singaporean banks as the only ones with durations beyond 6-months.

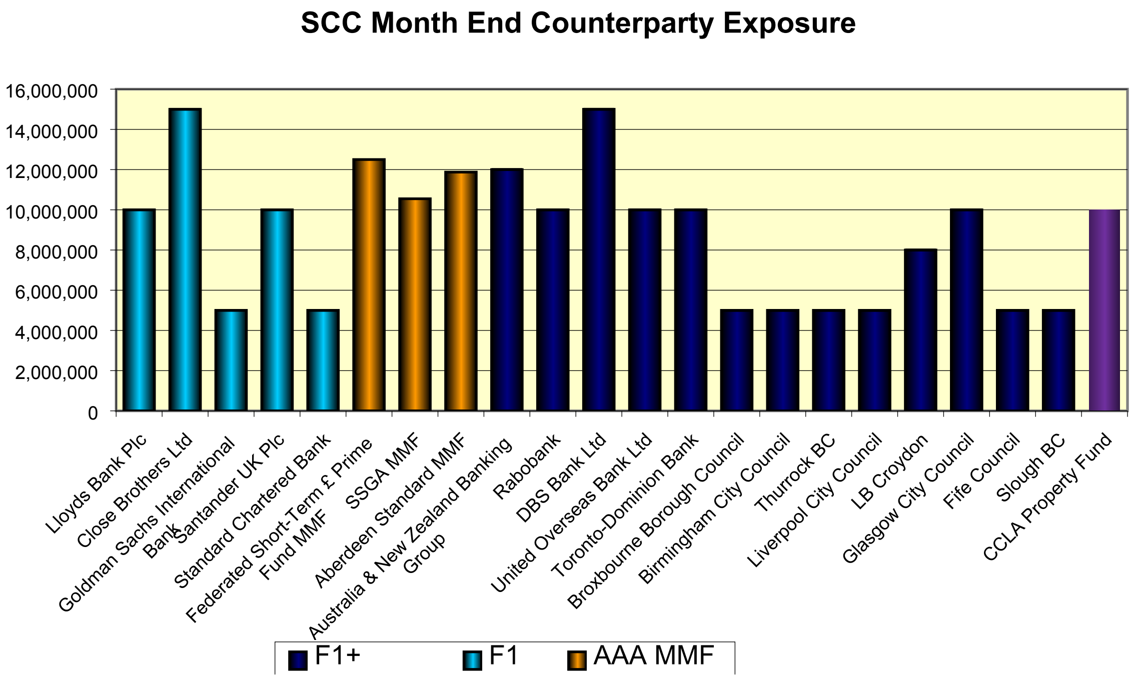
At year-end maximum durations per counterparty were as follows: -

- Barclays, Goldman Sachs International Bank, Nat West, and RBS – **100 days;**
- Bank of Scotland, Close Brothers, Handelsbanken Plc, HSBC Bank Plc, Lloyds Bank, Nationwide BS, Santander UK, Standard Chartered, DZ Bank, Landesbank Hessen-Thuringen, Nordea, OP Corporate, Rabobank and all Australian and Canadian banks – **6-months;**
- DBS Bank, OCBC, and UOB (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 139 days. This reduced in July to 123 days and ended the year at 156 days. This is consistent with the generally accepted outlook for Interest Rates, i.e. to shorten the duration of the portfolio in anticipation of a rate rise and investing longer when a levelling off or reduction of rates is anticipated. The average duration for the year was just short of 5 months.

In order to increase diversification of the portfolio, more deposits were placed with UK Local Authorities. Twenty-one loans were with Local Authorities 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 2019.



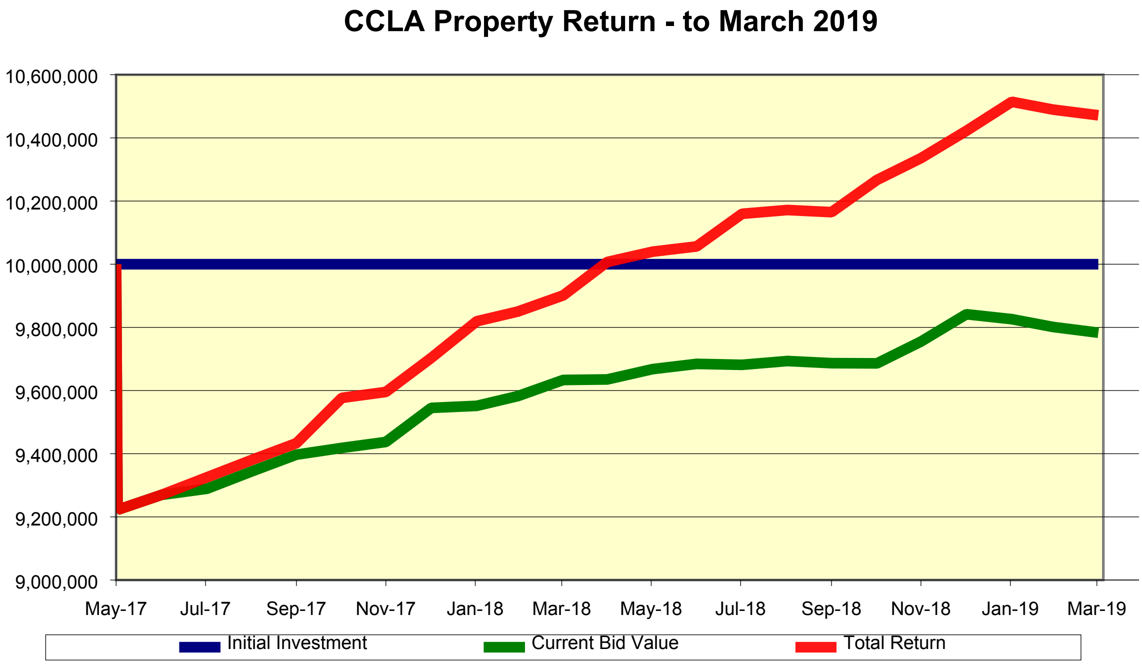
Liquidity: In keeping with the CLG guidance, the Council maintained a sufficient level of liquidity through the use of call accounts, money market funds (MMFs), and short-term deposits. Some call accounts and MMFs offered yields in excess of those on offer for time deposits up to 3-months, which meant 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 2017, 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.

As at 31st March 2019 the Net Asset Value of the SCC holding was £9,937,144.41 and a Bid Price (value at which investment could be sold) of £9,783,243. The current reduced value in relation to the original investment was anticipated and is caused by the bid / offer spread. The value of the fund has steadily increased since the initial May 2017 investment, but valuations have fallen very slightly in the past 3 months. In the meantime, the average Property Fund yield of circa 4.25% net, was circa 3.4% above average cash yields, and provided approximately £340,000 of extra income during the year. A graph of returns is shown below.



Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. Although economic data had not in itself warranted an increase in base rate, it was widely accepted that the BoE wanted to raise base rate, so they had some ammunition in the event of a Brexit related downturn. The increase was duly delivered in August with the MPC reiterating the mantra of further rises to be 'of gradual pace and to a limited extent'. Market rates continued to anticipate a further rise within the year until sentiment changed as the Brexit impasse unfolded, leading to rates dropping off during the last 6-weeks of the year. 1-month, 3-month, 6-month and 12-month LIBID rates averaged 0.53%, 0.67%, 0.79% and 0.94% respectively for 2018-19, and at 31st March 2019 were 0.61%, 0.72%, 0.83% and 0.94%. Given the actual and anticipated rate rises during the year, the 2018-19 average rates for 3-month, 6-

month and 12-month LIBID were 0.29%, 0.39%, and 0.34% basis points above those for 2017-18. A table of rates is shown below.

Money Market Rates 2018-19 (LIBID Source = ICE LIBOR previously BBA LIBOR)

Comfund

	O/N LIBID	7-Day LIBID	1-Month LIBID	3-Month LIBID	6-Month LIBID	12-Month LIBID	2-Yr SWAP
01/04/2018	0.35	0.36	0.39	0.59	0.70	0.88	1.10
30/04/2018	0.35	0.37	0.39	0.59	0.68	0.85	1.05
31/05/2018	0.35	0.36	0.37	0.49	0.59	0.76	0.93
30/06/2018	0.34	0.36	0.38	0.55	0.66	0.84	1.01
31/07/2018	0.33	0.50	0.56	0.67	0.78	0.93	1.11
31/08/2018	0.58	0.58	0.60	0.68	0.77	0.92	1.10
30/09/2018	0.58	0.59	0.60	0.68	0.78	0.94	1.14
31/10/2018	0.57	0.59	0.60	0.69	0.80	0.93	1.12
30/11/2018	0.56	0.58	0.61	0.77	0.89	1.01	1.17
31/12/2018	0.55	0.58	0.61	0.79	0.91	1.05	1.16
31/01/2019	0.55	0.58	0.61	0.79	0.90	1.04	1.09
28/02/2019	0.55	0.57	0.60	0.73	0.87	1.01	1.10
31/03/2019	0.55	0.57	0.61	0.72	0.83	0.94	0.96
Average 2018-19	**0.49**	**0.51**	**0.53**	**0.67**	**0.79**	**0.94**	**1.09**
Minimum	0.33	0.35	0.37	0.48	0.59	0.75	0.89
Maximum	0.58	0.59	0.61	0.81	0.92	1.06	1.23
Spread	0.25	0.24	0.24	0.33	0.33	0.31	0.34
Average 2017-18	**0.20**	**0.21**	**0.23**	**0.28**	**0.40**	**0.60**	**0.73**
Difference in average	**+0.29**	**+0.30**	**+0.30**	**+0.39**	**+0.39**	**+0.34**	**+0.36**

Comfund investment decreased to £151.15m at year-end 2019, by £28.53m from the £179.68m at year-end 2018.

The total of other investors’ balances also decreased slightly by £0.88m.

The average balance of the Comfund throughout 2018-19 was £167m, a £40m decrease on the previous years’ average.

The Comfund vehicle, with an annual return of 0.86% out-performed the benchmark for the year, by 0.20%.

A total of approximately £1.44m was earned in interest in the year, an increase of £200,000 on the figure for 2017-18 of £1.24m, despite reduced balances of £40m and reductions in investment duration for many counterparties.

Comfund administration charges received from investors totalled approximately £28,800 for the year.

Revenue

Revenue balances averaged £36.96m during the year, with an average yield of 0.68%. 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 0.51%. This income stream earned interest of over £252,000.

Property Fund

An investment of £10m was made in the CCLA Property Fund on 31st May 2017. For the year to 31st March 2019 it delivered an average net income yield of 4.25%, and £423,739 cash.

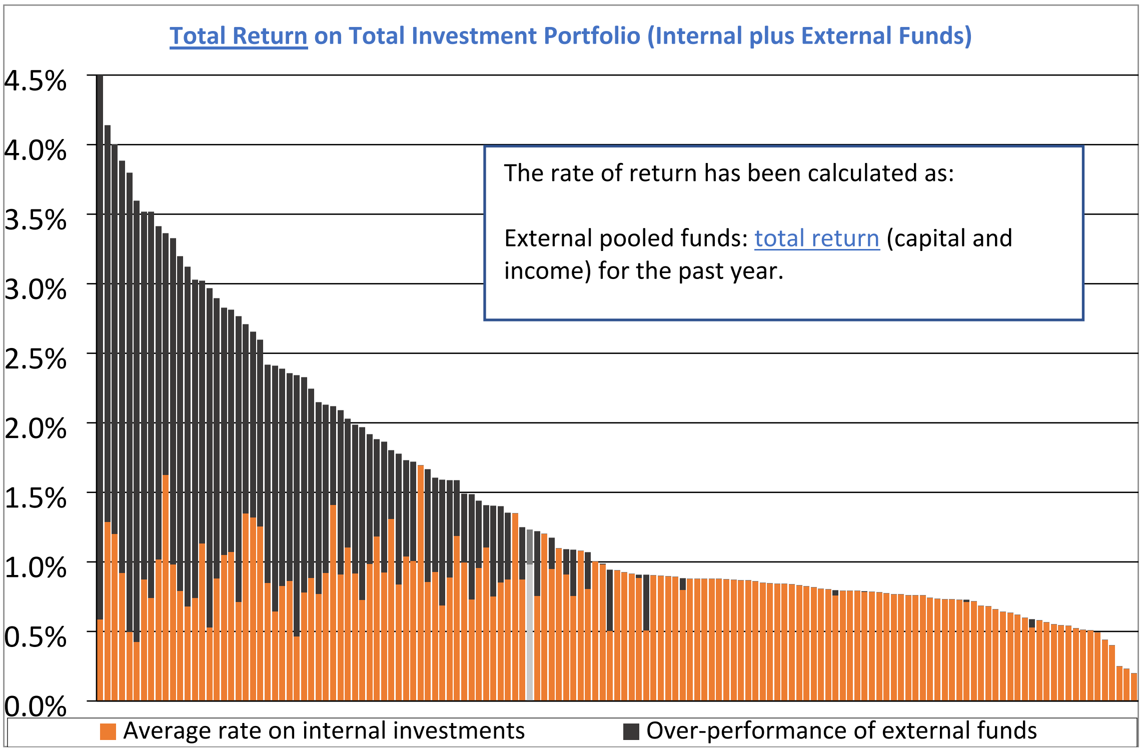
Combined

The combined average daily balance of the Council's investments during 2018-19 was £214.4m against £249.2m for 2017-18. The overall weighted investment return of combined investments was 0.99% against a return of 0.69% for 2017-18. Excluding the Property Fund, cash returns were 0.83% compared to 0.56% for 2017-18.

2018-19 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, figures for internally managed investments only, has been used. The Arlingclose report compares quarter-end figures only, and comparisons can be seen below.

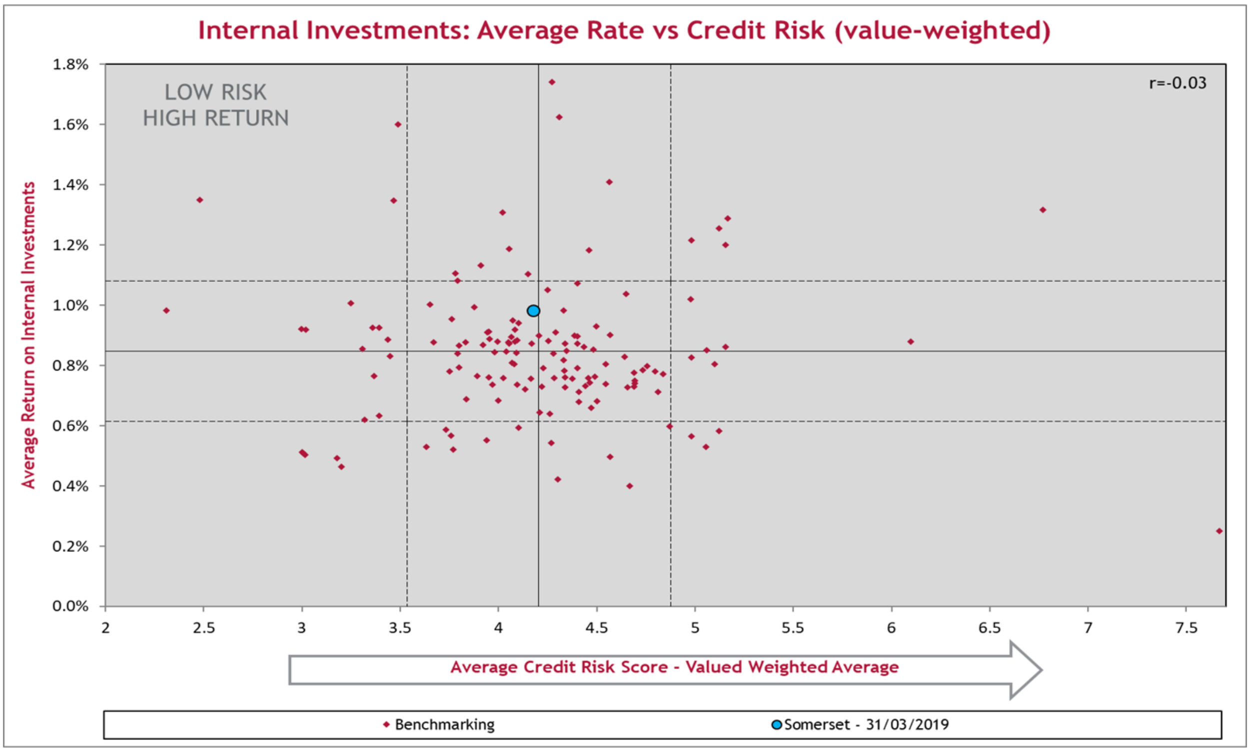
	Average Rate		Average Balance	
	SCC	Others	SCC	Others
June 2018	0.74%	0.66%	£208m	£64m
September 2018	0.88%	0.76%	£195m	£60m
December 2018	0.91%	0.81%	£180m	£60m
March 2019	0.98%	0.85%	£185m	£51m
Average	**0.88%**	**0.77%**	**£192m**	**£59m**

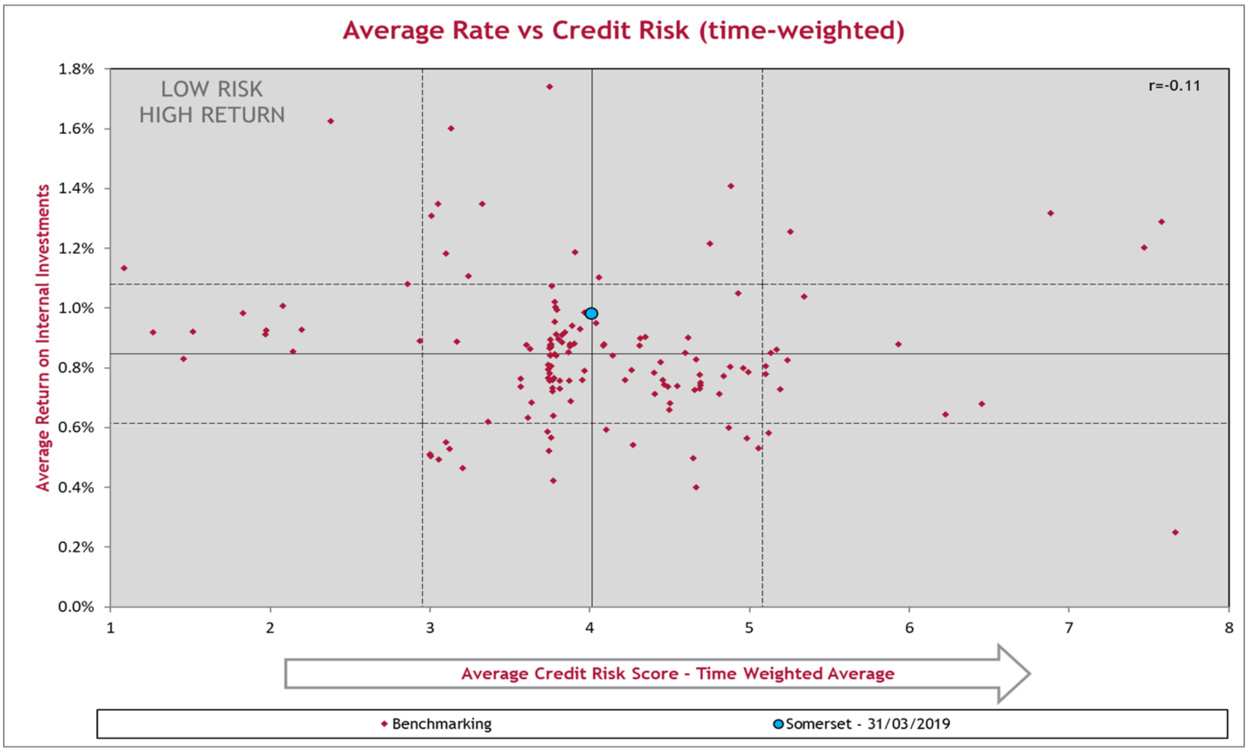
Using this methodology, SCC performance has been above that of comparators. This has been achieved with an average investment balance of more than 3 times that of the average for the universe. Returns as at 31st March 2019, including esoteric investments can be seen in the graph below (If in black & white, SCC is the bar above the 2nd 's' 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 year-end average days to maturity with that of other County Councils, the SCC average of 111 days is more than **1.5 years** below the 692 days for other County Councils. This in part reflects the fact that SCC is holding approximately £35m 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 at or below the average credit risk score.





Security and liquidity have been achieved while returning an overall rate in excess of average cash rates for all periods up to 1 year (see table above), on a portfolio with an average duration of less than 5 months (Excluding Property Fund). Performance was ahead of other Arlingclose advised Authorities' internally managed investments.

The overall return has produced a total income of £2.12m, up by £390,000 from 2017-18 on much reduced balances but higher 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), the return would have averaged approximately 0.42%, or £900k, a reduction in income of £1.21m.

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 £167,195.

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 2017-18 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 2018 report, and was raised to 86.5p-87p in the pound.

One further dividend has been received during 2018-19, £25,787.33 on 30th August 2018. 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 2019 £23,241,306.63 had been recovered. The shortfall of £1.76m 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 monthly.

The Council can confirm that it has complied with its Prudential Indicators for 2018-19. Those indicators agreed by Full Council and actual figures as at 31st March are included below:

Borrowing	Limit for 2018-19	As at 31-03-19
Authorised Limit	437	332
Operational Boundary	403	332
Upper limit – Fixed Interest	100%	100%
Upper limit – Variable Interest	30%	0%

Maturity Structure of Borrowing	Upper	Lower	Actual
Under 12 months	45%	15%	34.9%
>12 months and within 24 months	20%	0%	0.0%
>24 months and within 5 years	20%	0%	1.5%
>5 years and within 10 years	20%	5%	9.3%
>10 years and within 20 years	20%	5%	10.8%
>20 years and within 30 years	20%	0%	0.0%
>30 years and within 40 years	45%	15%	43.5%
>40 years and within 50 years	15%	0%	0.0%
>50 years and above	5%	0%	0.0%

Limit for Principal sums invested > 364 days £100m **Actual** £23m

Appendix I

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

Some Local Authorities have continued to invest 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 continue to voice 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 was revised, effective 1st April 2018. The CIPFA Treasury Management and Prudential Codes were also reviewed and updated.

As SCC is currently looking into the feasibility of alternative investments 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 fully incorporated into the 2019-20 Treasury Management Strategy, and the new separate Investment Strategy.

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. This new high-level paper was initiated for 2019-20 and approved by Full Council at the February 2019 meeting.

In the revised Treasury Management Code the definition of 'investments' was 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. SCC produced an Investment Strategy separate to that of the Treasury Strategy for 2019-20, which was also approved by Full Council in February. This paper set out detailed processes, policies and procedures which would need to be adopted if alternative investments were to be undertaken.

<u>MHCLG Investment Guidance and Minimum Revenue Provision (MRP)</u>

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 included 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 introduced the concept of proportionality, proposed 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.

<u>MiFID II</u>

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 continues to meet 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 2018.

Officers from the Treasury Management team reported debt and investment positions and performance via comprehensive reports at monthly meetings with the Director of Finance 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 2018-19, 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.