

Performance and Finance Scrutiny Committee
9 July 2020
Treasury Management Annual Report (2019/20)
Director of Finance and Support Services

Executive Summary
<p>The Council is required by regulations issued under the Local Government Act 2003 to review an annual treasury management report detailing borrowing and investment activity (<i>as compared with the approved Treasury Management Strategy</i>) and actual prudential and treasury indicators for 2019/20 (<i>as contained within the approved Budget Report</i>). The attached report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) "Code of Practice on Treasury Management" (the Code) and the CIPFA "Prudential Code for Capital Finance in Local Authorities" (the Prudential Code).</p> <p>The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. The annual treasury management report is therefore important in that it provides details of the outturn position for treasury activities and highlights compliance with policies previously approved by County Council.</p> <p>Due to the timing of the Covid-19 pandemic, significant market volatility was evident towards the end of the financial year. Whilst there is only minimal impact on the Council's investment returns in 2019/20, the market valuations of the Council's externally managed pooled funds were significantly affected with an unrealised loss at 31 March 2020 of £2.1m.</p>
Treasury Management Strategy (2019/20)
<p>The Council has substantial amounts of borrowings and investments and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The Council's risk procedures regarding its treasury management activities focus on the unpredictability of financial markets and implementing restrictions to minimise these risks. Additionally, the Council has regard to the Ministry for Housing, Communities and Local Government's (MHCLG) "Investment Guidance" that:</p> <ul style="list-style-type: none">• Emphasises the need for investments to focus on security and liquidity, rather than yield;• Recommends that treasury management strategies include details of assessing credit risk;• Details reasons for borrowing in advance of need (if appropriate); and• Details the use of treasury management advisors in undertaking treasury management activities. <p>Financial risks (including credit and liquidity risks) are minimised through compliance with the annual Treasury Management Strategy, which incorporates</p>

the prudential and treasury indicators, approved for 2019/20 by County Council in February 2019. During 2019/20 the Council complied with all statutory and regulatory requirements which require officers to identify and where possible quantify the levels of risk associated with its treasury management activities.

The Council confirms the following borrowing and investment activity in 2019/20:

- Borrowing: Given the significant borrowing need in the approved capital programme (up to March 2024) the Council took advantage of the very low borrowing rates offered by the Public Works Loan Board (PWLb) and borrowed an additional £100m during the first quarter of 2019/20; 50-year PWLB maturity loans at an average rate of 2.22%. Furthermore, £7m (plus interest) was repaid to the PWLB as per the terms and conditions of the £70m borrowing taken during April 2011. As a consequence of the PWLB activity during 2019/20, the Council's level of internal borrowing (the use of internal resources in lieu of external borrowing) fell to £28.7m at 31 March 2020 (£125.3m at 31 March 2019).
- At 31 March 2020 the Council's PWLB borrowing (external borrowing for capital purposes) was £481.8m (£388.8m at 31 March 2019). The Council's total external debt at 31 March 2020 remained within the "Authorised Borrowing Limit" approved by County Council in February 2019 (£553.7m; excluding PFI schemes and finance leases).
- Interest payable to PWLB during 2019/20 was £19.5m at an average rate of 4.09%. The additional revenue cost resulting from the £100m new PWLB debt taken was met from service contributions towards the cost of borrowing relating to income generating initiatives and increased interest receipts due to higher investment balances than originally forecast.
- Additionally, the Council's treasury management strategy allows occasional short-term borrowing to cover day-to-day cash flow shortages. During 2019/20 no external borrowing was required for such occasions as they were funded either by way of overdraft facilities in place with the Council's main provider of banking services (Lloyds Bank Plc) or met from balances held in the Council's instant access bank accounts and short-term Money Market Funds.
- Investments: The Council's investment strategy was maintained by following the approved counterparty policy as set out in its Treasury Management Strategy for 2019/20. Security of capital remained the primary objective for all of the Council's internally managed investments. The Director of Finance and Support Services confirms that there were no breaches of the approved investment strategy during the period. Externally managed investments (pooled funds) continued to be approved to help mitigate the effects of low investment returns.
- At 31 March 2020 the Council's investments totalled £338.1m (£204.8m at 31 March 2019). Gross investment interest received during 2019/20 was £4.0m, representing a return of 1.27% on an average investment portfolio of £313.2m.

WSCC Average Investments	Mar-19 £'m	Mar-19 %	Mar-20 £'m	Mar-20 %
UK Banks: Unsecured Deposits	57.1	20.5	71.3	22.8
UK Banks: Secured Deposits	8.2	2.9	7.2	2.3
Non-UK Banks: Unsecured	45.4	16.3	32.1	10.2
Local Authority	59.3	21.3	59.4	19.0
Housing Associations	0.0	0.0	5.7	1.8
Non-Bank Corporates	2.2	0.8	0.7	0.2
Money Market Funds	68.5	24.6	73.5	23.5
Externally Managed Pooled Funds	37.9	13.6	63.3	20.2
Total	278.6	100.0	313.2	100.0

Focus for Performance and Finance Scrutiny Committee

The Committee is asked to review and comment on the Treasury Management Annual Report.

Treasury Management Annual Report (2019/20)

1. Introduction

- 1.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and report on the actual prudential and treasury indicators for 2019/20. This regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report therefore summarises the following:
 - UK economic overview and interest rate movements during 2019/20 (*Section 2*)
 - Capital activity during 2019/20 (*Section 3*)
 - The Council's overall treasury position (*Section 4*)
 - Borrowing activity during the year (*Section 5*)
 - Activity of treasury investments made under statutory "power to invest" provisions granted to the Council by the Local Government Act 2003 (*Section 6*)
 - Actual performance of treasury investments as compared with budgeted returns (*Section 7*)
 - A schedule of non-treasury investments (*Section 8*)
 - The actual prudential and treasury indicators (*Appendix 1*)
 - A list of the Council's treasury investments as at 31 March 2020 (*Appendix 2*)
 - The impact of Covid-19 on future treasury management activities (*Appendix 3*)
- 1.2 The Council's Treasury Management Strategy for 2019/20, originally approved by County Council on 15 February 2019 (Agenda Item 5; Annex

2b) can be accessed on:

<https://westsussex.moderngov.co.uk/mgChooseDocPack.aspx?ID=618>

2. UK Economy and Interest Rates

- 2.1 Brexit remained a key issue throughout 2019 with repeated battles in the UK Parliament failing to agree a way forward for the UK over the issue of leaving the European Union (EU); resulting in the December 2019 general election. The decisive victory for the Conservative Party enabled the UK to leave the EU on 31 January 2020, however this still left much uncertainty as to whether there would be a reasonable trade deal achieved by the target deadline of the end of 2020; it is also unclear as to whether the coronavirus outbreak may yet impact on this deadline.
- 2.2 UK economic growth in 2019 was very volatile with the first quarter unexpectedly strong at +0.5%, the second quarter down at -0.2%, the third quarter bouncing back up to +0.5% and the fourth quarter flat at 0.0% (+1.1% year-on-year). The year 2020 started with optimistic business surveys pointing to an upswing in growth; however the monthly Gross Domestic Product (GDP) statistics in January 2020 were disappointing being stuck at 0.0% growth. Since then the whole world has changed as a result of the coronavirus outbreak. Preliminary forecasts indicated that the closedown of whole sections of the economy would result in a fall in GDP of at least 15% in the quarter ending June 2020. What remains uncertain is the extent of the damage that will be done to businesses by the end of the lockdown period, whether there could be a second wave of the outbreak and how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the UK economy will recover.
- 2.3 UK Consumer Price Index (CPI) inflation posed little concern for the Bank of England's Monetary Policy Committee (MPC) during 2019/20, ranging between 2.1% (April 2019) and 1.5% (March 2020). It is also not going to be an issue in the near future with the world economy heading into a recession which is already causing a glut in the supply of oil which fell sharply in price during April 2020. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not forecast in the UK.
- 2.4 Against this economic background the MPC maintained the Bank Rate at 0.75% through to March 2020; at this point however it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE) by the Bank of England of £200bn. The Government and the Bank were also very concerned with stopping people losing their jobs during the lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs, initially for the three months that the country was expected to remain in lockdown. They also put in place a raft of other measures to help businesses access loans from their banks (with the Government providing

guarantees to the banks against losses) to tide them over the lockdown period when some firms may have little or no income.

- 2.5 The measures to support jobs and businesses already taken by the UK Government will result in a huge increase in the annual budget deficit in 2020/21 (from 2% to nearly 11%). The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the March 2020 Budget the Government announced a large increase in spending on infrastructure helping the economy to recover once the lockdown is ended. Provided the coronavirus outbreak is brought under control relatively swiftly and lockdown measures are eased it was hoped that there would be a sharp recovery; but currently it is forecast that recovery will take a prolonged time to fully recover previous lost momentum.
- 2.6 Investment Rates: Investment returns remained low during 2019/20. Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the UK Parliament but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March investment rates initially plunged but then sharply rose back up again by the end of March due to a shortage of liquidity in financial markets.
- 2.7 A summary of the London Interbank Bid Rates (LIBID) throughout 2019/20 is shown in the table below:

Date	Bank Rate	O/N LIBID (%)	7-day LIBID (%)	1-month LIBID (%)	3-month LIBID (%)	6-month LIBID (%)	1-year LIBID (%)
01/04/2019	0.75	0.55	0.57	0.60	0.72	0.83	0.93
30/04/2019	0.75	0.56	0.57	0.61	0.69	0.82	0.97
31/05/2019	0.75	0.56	0.58	0.60	0.67	0.75	0.87
30/06/2019	0.75	0.55	0.56	0.60	0.65	0.73	0.83
31/07/2019	0.75	0.54	0.56	0.59	0.65	0.69	0.73
31/08/2019	0.75	0.56	0.56	0.58	0.63	0.66	0.71
30/09/2019	0.75	0.54	0.57	0.59	0.63	0.70	0.76
31/10/2019	0.75	0.55	0.57	0.59	0.68	0.75	0.85
30/11/2019	0.75	0.55	0.56	0.58	0.67	0.73	0.82
31/12/2019	0.75	0.55	0.57	0.58	0.67	0.76	0.86
31/01/2020	0.75	0.55	0.56	0.58	0.64	0.69	0.75
29/02/2020	0.75	0.56	0.56	0.55	0.55	0.56	0.63
31/03/2020	0.10	-0.07	0.01	0.12	0.47	0.60	0.74
Minimum	0.10	-0.07	0.00	0.11	0.26	0.31	0.39
Average	0.72	0.52	0.53	0.56	0.63	0.70	0.80
Maximum	0.75	0.56	0.58	0.61	0.72	0.83	0.98

- 2.8 Borrowing Rates: During 2019 global bond market prices rose and yields fell to very low levels on heightened expectations that the US could be heading for a recession and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China. Together with inflation generally at low levels in most countries (and expected to remain subdued) these conditions were conducive to very low bond yields.

- 2.9 In line with global bond markets, UK Gilt yields were on a falling trend during 2019/20 making local authority borrowing attractive if needs could be demonstrated. Following the coronavirus crisis hitting western economies Gilt yields fell sharply to unprecedented lows, as investors were panicked into selling shares and moved cash back into safe haven assets (government bonds) in anticipation of impending recessions in western economies. Fiscal policy responses to the crisis have seen a huge and quick expansion of government expenditure financed by issuing government bonds (which would normally cause bond yields to rise); however at the same time major western central banks have also started significant quantitative easing purchases of government bonds which will act to maintain downward pressure yields.
- 2.10 Public Works Loan Board (PWLB) borrowing rates are determined by UK Gilt yields through HM Treasury determining a specified margin to add to gilt yields. In October 2019 and without any prior warning, HM Treasury imposed a change in the margins over gilt yields for PWLB borrowing rates by adding an additional 1% margin over gilts to all PWLB rates. This was seen by many market commentators as a way of stopping the significant amount of government backed funding for local authority commercial investments. As a result from October 2019 the PWLB Certainty Rate available to the Council was set at Gilt plus 180 basis points (previously Gilt plus 80 basis points).
- 2.11 Prevailing PWLB borrowing rates for maturity loans (including the 0.2% "Certainty Rate" discount available to UK local authorities) during 2019/20 are shown below:

Date	PWL Notice	1-Year PWL (%)	5-Year PWL (%)	10-Year PWL (%)	20-Year PWL (%)	25-Year PWL (%)	50-Year PWL (%)
01/04/2019	128/19	1.46	1.52	1.84	2.35	2.41	2.24
30/04/2019	167/19	1.55	1.68	2.02	2.49	2.54	2.38
31/05/2019	209/19	1.42	1.41	1.70	2.23	2.30	2.16
30/06/2019	249/19	1.43	1.41	1.68	2.23	2.30	2.16
31/07/2019	295/19	1.26	1.20	1.50	2.13	2.22	2.12
31/08/2019	338/19	1.24	1.09	1.21	1.74	1.82	1.68
30/09/2019	380/19	1.28	1.07	1.27	1.77	1.83	1.67
31/10/2019	426/19	2.41	2.21	2.41	2.93	3.00	2.85
30/11/2019	468/19	2.41	2.26	2.45	2.97	3.03	2.88
31/12/2019	506/19	2.42	2.43	2.67	3.16	3.22	3.05
31/01/2020	044/20	2.36	2.20	2.33	2.81	2.86	2.71
29/02/2020	084/20	2.22	2.08	2.23	2.71	2.77	2.59
31/03/2020	128/20	1.90	1.95	2.14	2.61	2.65	2.39
Minimum	n/a	1.17	1.00	1.13	1.65	1.73	1.57
Average	n/a	1.83	1.77	2.00	2.49	2.56	2.40
Maximum	n/a	2.47	2.45	2.76	3.20	3.25	3.05

- 2.12 There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very

low during this period and could even turn negative in some major western economies during 2020/21.

- 2.13 Additionally, in March 2020 the UK Government announced that there would be a consultation with local authorities (ending on 31 July 2020) on possibly amending the 'increased' PWLB borrowing margins (as set out in paragraph 2.1). However it remains clear that HM Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

3. Capital Expenditure and Financing

- 3.1 The Council undertakes capital expenditure on its long-term assets; additionally the capital programme includes schemes aimed at generating income and promoting economic growth. These capital activities may either be:

- Financed immediately through the application of capital or revenue resources (including capital receipts, capital grants, external contributions and revenue contributions) which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need, which may be sourced either through external borrowing or internal borrowing (in lieu of external borrowing).

- 3.2 Actual capital expenditure and how this was financed in 2019/20 (as compared with the original capital budget approved in February 2019) is shown in the tables below:

Capital Expenditure	2019/20 Budget £'m	2019/20 Actual £'m
Core Programme	92.8	84.5
Income Generating Initiatives (IGIs)	16.2	7.0
Total Capital Expenditure	109.0	91.5

Capital Financing	2019/20 Budget £'m	2019/20 Actual £'m
Capital Receipts	-3.8	-7.9
Government Grants	-70.7	-69.1
External Contributions (including S106)	-5.8	-6.8
Revenue Contributions to capital outlay	-2.1	-0.3
Borrowing (unfinanced capital expenditure)	-26.6	-7.4
Total Financing	-109.0	-91.5

- 3.3 Actual capital expenditure forms one of the prudential indicators required by the Chartered Institute of Public Finance and Accountancy (CIPFA) Codes. A summary of the Council's prudential and treasury indicators (as approved

within 2019/20 treasury management strategy; and revised within the 2020/21 treasury management strategy) are reported at **Appendix 1.**

4. Overall Treasury Position

- 4.1 Throughout 2019/20 the Council maintained a cautious approach in regards to its internally managed investments, whereby investments continued to be dominated by low counterparty risk considerations resulting in relatively low returns throughout the period. However, exposure to both externally managed pooled funds (property and multi-asset income funds) and longer-term investments (bank secured bonds, local authority loans and housing association loans) continued to help mitigate the effects of such low investment returns during the financial year.
- 4.2 Given the significant borrowing need in the approved capital programme (up to March 2024) the Council took advantage of the low borrowing rates offered by the PWLB (see paragraph 2.11) and borrowed an additional £100m during the first quarter of 2019/20; 50-year PWLB maturity loans at an average rate of 2.22%. The Council's resulting PWLB borrowing at 31 March 2020 (£481.8m) remained within the "Authorised Borrowing Limit" approved by County Council in February 2019 (£553.7m).
- 4.3 At the beginning and the end of 2019/20 the Council's actual treasury positions (excluding borrowing by PFI and finance leases) were as follows:

Borrowing (Excluding PFI and Finance Leases)	31/03/19 Actual £'m	31/03/20 Actual £'m
Borrowing Requirement	519.1	515.5
Less: Long-Term Debt (PWLB)	-388.8	-481.8
Less: Short-Term Debt (Non-PWLB) - <i>Paragraph 4.4</i>	-5.0	-5.0
Internal Borrowing	125.3	28.7

Investments	31/03/19 Actual £'m	31/03/20 Actual £'m
Total Investments	204.8	338.1

- 4.4 Throughout 2019/20 the Council continued to hold cash on behalf of the Chichester Harbour Conservancy as part of the Harbour's own investment strategy. This is presented as short-term debt on the Council's Balance Sheet as the amount is available for repayment on any given notice.
- 4.5 The movement in the Council's internal borrowing during 2019/20 is detailed below:

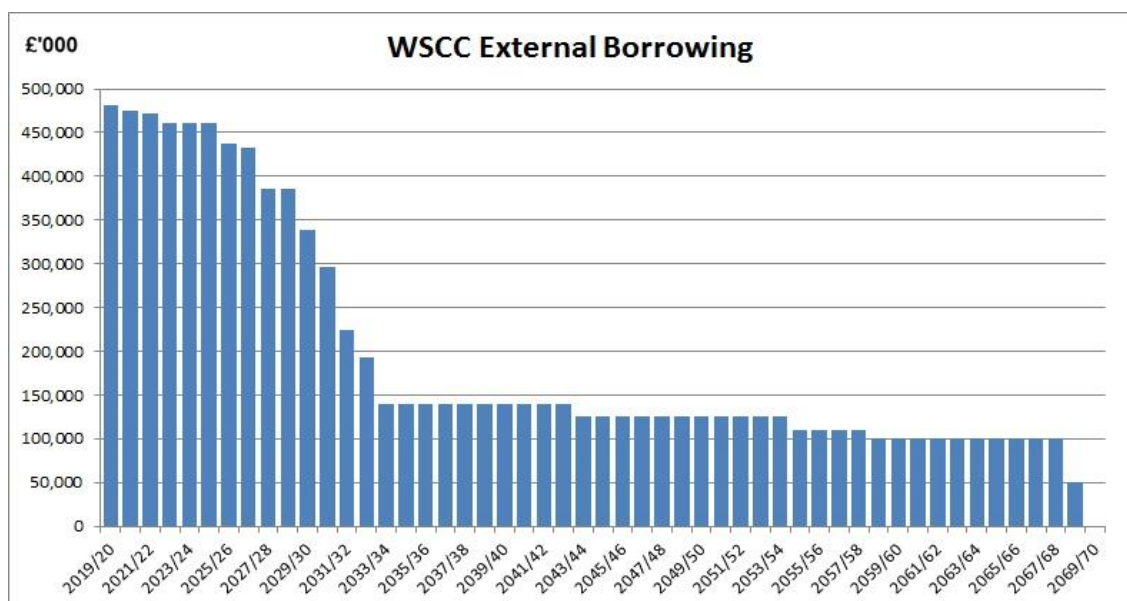
Internal Borrowing Movement	£'m
Internal Borrowing (at 31 March 2019)	125.3
Capital expenditure (<i>to be funded through borrowing</i>)	7.4
New PWLB Debt (<i>approved Q1 2019/20</i>)	-100.0
Repayment of PWLB Debt (EIP Loans)	7.0

Short-Term Debt (<i>movement</i>)	0.0
Revenue Provision for Repayment of Debt	-11.0
Internal Borrowing (at 31 March 2020)	28.7

- 4.6 Total investments as reported in paragraph 4.3 (and throughout this report) differ slightly from the totals presented in the Council's Financial Statements. Tables contained within this Annual Report exclude technical accounting entries in accordance with UK Accounting Standards that require investments be shown inclusive of accrued interest and expected credit losses (where appropriate) on the Council's Balance Sheet.
- 4.7 The ongoing impact of the Covid-19 pandemic on the Council's future treasury management activities is currently under review. An initial assessment of the impact on the Council's 2020/21 borrowing and investment strategies is reported in **Appendix 3**; with these to be continually reviewed over the coming months as further developments become known.

5. Borrowing

- 5.1 As reported in Section 4, the Council approved £100m new PWLB borrowing in 2019/20; additionally £7.0m (plus interest) was repaid to the PWLB relating to the £70m borrowing taken during April 2011 (leaving £10.5m to be repaid by April 2021). Following the new borrowing the Council maintained an internal-borrowing position, but at a far reduced amount to that reported at 31 March 2019 (see paragraphs 4.3 and 4.5).
- 5.2 As a result the Council's total external borrowing at 31 March 2020 (the funding of previous years' capital programmes; all arranged via the PWLB) including the loan undertaken on behalf of the Littlehampton Harbour Board in March 2015 (all related costs recoverable from the Harbour Board) was £481.8m (£388.8m at 31 March 2019) with the following maturity profile:



- 5.3 Interest payable to the PWLB relating to the Council's long-term borrowing amounted to £19.5m in 2019/20 (£17.8m in 2018/19); representing an

average interest rate of 4.09%. Taking into account service contributions towards the cost of new borrowing relating to commercial property and Your Energy Sussex initiatives, the Council forecast a £0.6m revenue budget shortfall as a result of the additional £100m PWLB borrowing in 2019/20. The Director of Finance and Support Services approved funding this shortfall through additional income generated from higher investment balances arising from the new borrowing. As a consequence, actual interest payable was in line with the Council's revised 2019/20 budget as set out below:

Interest Payable: Revised Budget (2019/20)	£'m
Approved Budget (February 2019)	17.6
Services Contributions – Commercial Property	0.9
Services Contributions – Your Energy Sussex	0.4
Budget transfer from Investment Income	0.6
Revenue Budget 2019/20 (Interest Payable)	19.5

- 5.4 Given the significant borrowing requirement that remains approved within the Council's capital programme, the Director of Finance and Support Services continues to evaluate alternative funding sources to the PWLB including forward starting commercial loans whereby the interest rate is agreed in advance (fixed in context with current rates) but the cash is received in later years. The arrangement of such debt will therefore enable certainty of cost to be achieved without suffering an investment 'cost of carry' in the intervening period. As at 31 March 2020 however, no such forward starting loans had been approved.

6. Investments (Treasury)

- 6.1 The Council's investment policy has regard to MHCLG guidance, and is implemented through the Council's "Annual Investment Strategy" (as contained within the approved 2019/20 Treasury Management Strategy); all treasury investments were made under statutory provisions granted to the Council by the Local Government Act 2003 (Section 12; 'Power to Invest').
- 6.2 MHCLG Investment Guidance governs that the security and liquidity of the Council's internally managed investments remained primary investment objectives. The Council's investment strategy therefore approved limits regarding the monetary amounts and time durations of deposits arranged with individual counterparties. Additionally the strategy required that internally managed investments were not made with organisations unless they met identified minimum credit criteria; in particular counterparty credit quality was assessed and monitored with reference to credit ratings as provided by the three main credit rating agencies, supplemented by additional market data (including credit default swap prices, bank share prices and general media alerts).
- 6.3 The Council defined 'high credit quality' as institutions and securities having a long-term credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher (non-UK banks holding a credit rating of A+ or higher). The 2019/20 investment strategy further approved investments in BBB+ rated corporate (non-bank) organisations up to a maximum duration of 100 days; and the National

Westminster Bank Plc (ring-fenced part of the bank) up to a maximum of one year given the part nationalised status of the bank. The total level of internally managed investments with corporates (non-bank) rated below A- was limited to a maximum of £30m (£10m maximum per organisation).

- 6.4 Throughout 2019/20 the Council complied with all of the relevant statutory and regulatory requirements related to its treasury management activities. The Director of Finance and Support Services confirms that there were no breaches of the approved Treasury Management Strategy (including the Annual Investment Strategy) as set out above.
- 6.5 UK (and other country) banking legislation continued to place the burden of rescuing failing banks disproportionately onto unsecured creditors (including local authority investors) through the potential bail-in of unsecured bank deposits. While the Council has taken a cautious approach to investing, it is also fully appreciative of the changes to the regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the 2008 financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how banks are now more able to cope with extreme stressed market and economic conditions. As a consequence, the use of unsecured bank deposits, short-term Money Market Funds and short term loans to other UK local authorities remained an integral part of the investment strategy in maintaining adequate cash-flow liquidity as well as enhancing short-term investment returns.
- 6.6 Long term investment rates (greater than one year) were however higher than short term rates during the period meaning that value remained in placing longer term investments where cash balances were sufficient to allow this. In line with the Council's usable reserve forecasts (in particular long-term PFI reserve balances) and in accordance with the approved investment strategy, the Council maintained its long-term investments in approved property funds (CCLA, Hermes and Lothbury) and multi-asset income funds (Fidelity and NinetyOne [formerly Investec]). Additionally, given the maximum limit for investments greater than one year (£75m) the Council approved two-year loans with a UK local authority (Barnsley Metropolitan Borough Council) and a UK housing association (Metropolitan Housing Trust Ltd) and a three-year secured bond with Nationwide Building Society.
- 6.7 Therefore, in accordance with the approved treasury management strategy, investments held during 2019/20 included:

Non-Bank:

- Short-term investments (up to a maximum of one year) with other UK local authorities including: Aberdeen City Council, Blackpool Council, Cambridgeshire County Council, Croydon Council, Derbyshire County Council, Doncaster Metropolitan Borough Council, Dundee City Council, Glasgow City Council, Hackney Council, Haringey Council, Highland Council, Hull City Council, North Lanarkshire Council, Plymouth City Council, Salford City Council, Slough Borough Council, Southwark

Council, Stockport Metropolitan Borough Council, Surrey County Council and Thurrock Council.

- Fixed-rate bonds with Corporates (assigned a BBB+ credit rating or above): National Grid Gas Plc (UK).
- Long-term investments (greater than one year) with other UK local authorities including: Barnsley Metropolitan Borough Council (maturing November 2021) and Plymouth City Council (approved in 2018 and maturing April 2020).
- Long-term investments (greater than one year) with UK housing associations: Metropolitan Housing Trust Ltd (maturing September 2021); the Council has the right to request repayment within 100 days if the Metropolitan Housing Trust Ltd credit rating falls below its current A-long-term rating.

Bank Secured:

- Long-term covered bond (3-year floating rate note) with Nationwide Building Society (maturing August 2022).

Bank Unsecured:

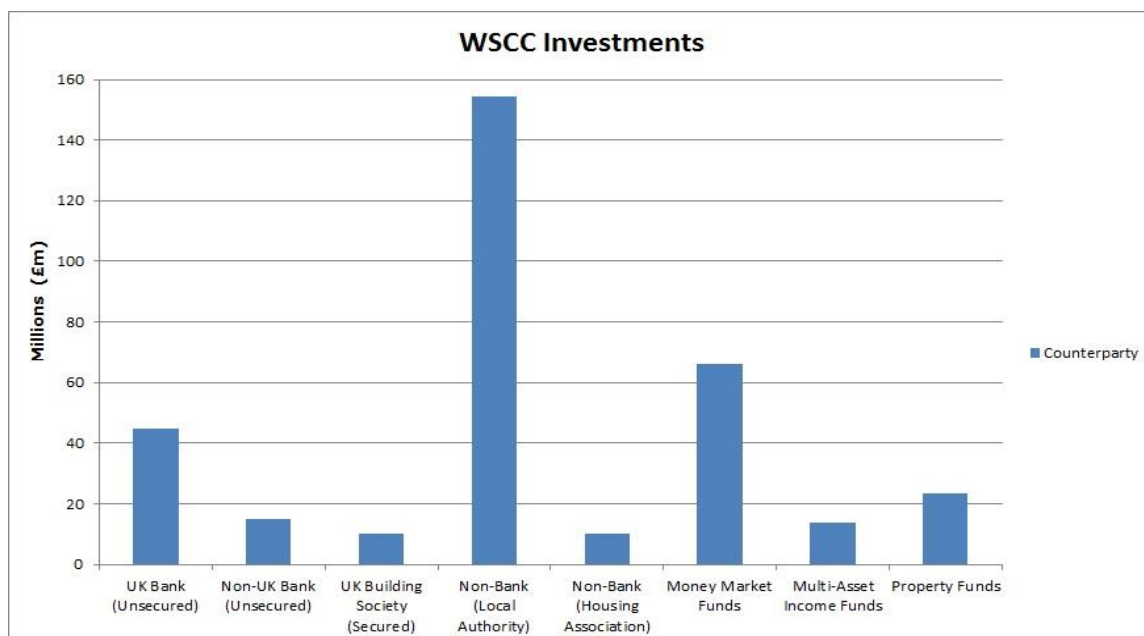
- Certificate of deposits, fixed-term deposits, instant access accounts, notice accounts and senior unsecured bonds with UK banks including: Goldman Sachs International Bank, Handelsbanken Plc, Lloyds Bank Plc, Nationwide Building Society, National Westminster Bank Plc, Santander UK Plc and Standard Chartered Bank.
- Fixed-term deposits with high credit quality non-UK Banks including: Australia & New Zealand Banking Group and Commonwealth Bank of Australia (Australia); and United Overseas Bank (Singapore).
- Money Market Funds holding a AAA credit rating, operating a low volatility net asset valuation and holding underlying assets in excess of £1bn: Aberdeen Standard, Blackrock, Deutsche, Federated (UK), Goldman Sachs and State Street sterling liquidity funds.

Externally Managed (Pooled Funds):

- Ultra-short dated bond funds (one year investment horizon): Federated (UK) Cash Plus Fund.
- Multi-asset income funds (three year investment horizon): Fidelity Multi-Asset Income Fund and NinetyOne (formerly Investec) Diversified Income Fund.
- Property Funds (minimum five year investment horizon): CCLA Local Authorities' Property Fund, Hermes Property Unit Trust and Lothbury Property Trust.

6.8 Internally managed investments in 2019/20 were arranged either through approved London money market brokers or by direct dealing with the relevant counterparty. Corporate bonds, covered bonds and certificate of deposits were held via a HSBC custodian service administered by King and Shaxson Ltd. Additionally, investments arranged with other UK local authorities were protected by statutory provisions set out in the Local Government Act 2003 that prevent default; due to these statutory provisions local authorities were viewed as similar to the UK Government.

- 6.9 At 31 March 2020 the Council's investments amounted to £338.1m as compared with £204.8m as at 31 March 2019. The full list of the Council's investments held at 31 March 2020 (£338.1m) is shown in **Appendix 2**. Additionally a breakdown of the Council's investments by counterparty type at this point in time is shown below:



- 6.10 At 31 March 2020 the Council was holding significantly higher cash balances in short-term loans (six to twelve months) with other UK local authorities, as compared with similar duration bank unsecured fixed-term deposits. This was a consequence of increased local authority borrower demand during the second half of 2019/20 outweighing supply; thereby increasing rates to levels higher than those offered by banks. The increased exposure to UK local authorities had the additional benefit of improving the credit profile of the Council's overall investment portfolio.
- 6.11 The cash movement in the Council's internally managed investments during 2019/20 is shown below:

Investment Activity in 2019/20	Balance on 1st April £'m	Investments Made £'m	Investments Sold £'m	Balance on 31st March £'m
UK Banks: Unsecured Deposits	31.5	145.2	-131.5	45.2
Non-UK Banks: Unsecured	15.0	40.0	-40.0	15.0
UK Banks: Secured Deposits	7.9	10.0	-7.9	10.0
Local Authority	31.0	179.5	-56.0	154.5
Housing Associations	0.0	10.0	0.0	10.0
Corporates (Non-Bank)	0.0	6.7	-6.7	0.0
Money Market Funds	80.1	1,062.9	-1,076.8	66.2
Total (Internally Managed)	165.5	1,454.3	-1,318.9	300.9
Multi-Asset Income Funds	15.3	0.0	-1.4 (i)	13.9
Property Funds	24.0	0.0	-0.7 (i)	23.3
Ultra-Short Dated Bond Funds	0.0	24.7	-24.7	0.0

Total Investments	204.8	1,479.0	-1,345.7	338.1
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(i) *Unrealised loss in fund valuations at 31 March 2020.*

- 6.12 Credit Risk: In demonstrating compliance with the Council's creditworthiness policy (as contained within the approved 2019/20 "Annual Investment Strategy") the movement in the Council's investment portfolio (actual cash position) by the credit rating of the financial institution, or the credit rating of the specific investment (for example covered bonds) if higher than the individual counterparty rating, is shown below:

Institution / Investment Credit Rating	Mar-19 £'m	Jun-19 £'m	Sep-19 £'m	Dec-19 £'m	Mar-20 £'m
AAA (i)	88.0	90.3	56.2	49.8	76.2
AA- (ii)	47.7	75.0	100.0	122.1	169.5
A+	14.8	14.9	14.9	15.1	15.2
A	0.0	44.9	59.9	63.2	30.0
A-	15.0	0.0	10.0	10.0	10.0
Internally Managed	165.5	225.1	241.0	260.2	300.9
Externally Managed (AAA)	0.0	24.5	24.6	24.6	0.0
Externally Managed (Other)	39.3	39.6	39.4	39.3	37.2
Total Investments	204.8	289.2	305.0	324.1	338.1

(i) *Includes short-term Money Market Funds and Covered Bonds.*

(ii) *Includes all non-rated UK local authorities (assumed AA- rating).*

- 6.13 Furthermore, the 2019/20 treasury management strategy approved that a maximum of £90m may be invested in non-UK organisations (excluding investments held in short-term Money Market Funds and externally managed Pooled Funds); with a maximum of £30m invested in any one sovereign (non-UK) state. The Council's investment portfolio split by sovereign is shown below:

Deposits by Sovereign	Mar-19 £'m	Jun-19 £'m	Sep-19 £'m	Dec-19 £'m	Mar-20 £'m
Australia	15.0	30.0	30.0	25.0	15.0
Singapore	0.0	10.0	15.0	0.0	0.0
Internally Managed	15.0	40.0	45.0	25.0	15.0
UK (including Local Authority)	70.4	94.8	149.8	195.4	219.7
Money Market Funds	80.1	90.3	46.2	39.8	66.2
Externally Managed Funds	39.3	64.1	64.0	63.9	37.2
Total Investments	204.8	289.2	305.0	324.1	338.1

- 6.14 Counterparty credit quality can be further demonstrated by a benchmarking analysis of the Council's investment portfolio (*excluding the Council's multi-asset income and property fund investments*) undertaken by the Council's treasury management advisor-Link Group (Link Asset Services):

Benchmarking Date: 31 March 2020	Weighted Average Rate of Return	Weighted Average Time to Maturity (days)	Weighted Average Total Time (days)	Weighted Average Credit Risk
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Link Client Population Average	0.71%	71	153	2.81
English Counties (Link Clients)	0.74%	72	137	2.51
West Sussex County Council	0.87%	171	297	1.87

6.15 The Link Asset Services weighted average credit risk score ranges between 1 (low credit risk) to 7 (high credit risk). The analysis demonstrates that the Council's internally managed investment portfolio compares favourably against the average for all Link clients and remains comfortably within their recommended credit risk score range.

6.16 Liquidity Risk: As required by the CIPFA Code of Practice, the Council uses purpose built cash flow forecasting software (SAP Treasury Management Module) to determine the maximum period for which funds may prudently be invested. The maturity profile of County Council investments throughout 2019/20 is shown below:

Period to Maturity	Mar-19 £'m	Jun-19 £'m	Sep-19 £'m	Dec-19 £'m	Mar-20 £'m
Instant Access Accounts	81.8	90.4	46.2	40.0	66.4
Up to one month	43.9	20.0	19.9	25.0	25.0
One month to 3 months	10.0	0.0	50.0	25.3	45.0
3 months to 6 months	14.8	64.7	49.9	84.9	60.0
6 months to 1 year	5.0	50.0	55.0	60.0	79.5
Ultra-Short Dated Bond Fund	0.0	24.5	24.6	24.6	0.0
Greater than 1 year	49.3	39.6	59.4	64.3	62.2
Total Investments	204.8	289.2	305.0	324.1	338.1

6.17 Short-term Borrowing (for cash flow purposes): The Council has ready access to short-term borrowings from the money markets to cover any day-to-day cash flow needs. During 2019/20 however, daily cash flow shortages were funded either by way of overdraft facilities in place with the Council's main provider of banking services (Lloyds) or met from balances held in the Council's instant access bank accounts and Money Market Funds.

7. Investment Performance

7.1 The Council's budgeted investment income as approved in the 2019/20 Revenue Budget amounted to £2.0m; increased from £1.9m in 2018/19. The income budget reflected the Council's original forecast that Bank Rate would average around 1% during the period, together with the full year effect of higher yielding externally managed pooled funds for which investment commenced between September and December 2018.

7.2 During the second quarter of 2019/20 investment income forecasts for the year were updated to reflect both the expectation that Bank Rate would remain at 0.75% throughout the period and that additional cash balances were available for investments as a result of the £100m PWLB borrowing undertaken in April and June 2019. As a consequence, the revised estimate of 2019/20 gross investment income (before any adjustments for internal interest transfers) was £3.7m, based on the assumption that the Council would achieve an average interest rate of 1.32% on an assumed investment portfolio of £275m. Additionally, the investment income forecast included a

reduced estimate of £0.8m (£1.0m originally forecast) in respect of interest transfers to internal and external reserve balances held by the Council; including school accumulating funds, PFI/MRMC reserves and cash held on behalf of the Chichester Harbour Conservancy.

Investment Income: Revised Forecast (2019/20)	£'m
Original gross forecast: Interest receipts (February 2019)	3.0
Reduced interest: No change to Bank Rate in 2019/20	-0.3
Increased interest: Higher investment balances	1.0
Gross Interest Receipts	3.7
Budgeted transfer (revised) to/from specific reserves	-0.8
Interest received re monies held by Biffa West Sussex Ltd	0.2
Investment Income – Revised Forecast	3.1

- 7.3 Following this review the Director of Finance and Support Services approved increasing the investment income budget by an additional £0.7m in order to cover the forecast shortfalls in both 2019/20 interest payments (£0.6m; see paragraph 5.3) and other capital financing charges (£0.1m). The revised 2019/20 revenue budget as reported within the December 2019 Total Performance Monitor (TPM) is set out below. This includes £0.2m received in respect of the Materials Resource Management Contract (representing accrued interest on monies held by Biffa West Sussex Ltd as trustee of the Council since commencement of the contract) together with an additional £0.2m investment income surplus:

Investment Income: Revised Budget (2019/20)	£'m
Original Budget: Approved February 2019	2.0
Approved budget transfer (to capital financing charges)	0.7
2019/20 Revenue Budget (Revised)	2.7
Investment income surplus	0.4
Investment Income – Revised Forecast	3.1

- 7.4 As a result of several factors affecting cash balances, including capital programme slippage (£18m) and additional capital grants unapplied (£12m) the Council actually maintained average investment balances of £313.2m throughout 2019/20 (£278.6m in 2018/19). At 31 March 2020 the Council's gross investment income amounted to £4.0m (£3.0m in 2018/19) at an average rate of return of 1.27% (1.09% in 2018/19).
- 7.5 In accordance with the approved Treasury Management Strategy performance can be shown by three separate investment types representing liquidity, short-term investments (up to one year duration) and long-term investments (greater than one year). The performance of these investment types during 2019/20 is shown below:

Investment Type	Average £'m	Interest £'m	Rate of Return
Liquidity	73.7	0.5	0.70%
Short-Term Investments	174.2	1.6	0.93%
Long-Term Investments	65.3	1.9	2.84%

Total	313.2	4.0	1.27%
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- 7.6 In line with revised forecasts, £0.8m interest was paid to third parties and other internal balances held by the Council during 2019/20. As a result the actual performance of investment income throughout 2019/20 as compared against the revised Revenue Budget forecast (paragraph 7.3) is summarised below:

Interest Receipts (2019/20)	£'m
Expected Gross Interest Receipts	3.7
Lower rate of return than revised budgeted rate (-0.05%)	-0.2
Higher average investment portfolio than assumed (at 1.32%)	0.5
Actual Interest Received	4.0
Interest paid to third parties and internal reserves	-0.8
Interest received re monies held by Biffa West Sussex Ltd	0.2
Net Interest Received (2019/20)	3.4
Revenue Budget 2019/20 (Paragraph 7.3)	2.7
Additional Interest/Shortfall(-)	0.7

- 7.7 The total investment income surplus was used to partially mitigate the Council's revenue budget overspend in 2019/20; as a consequence no transfers were made to the Interest Smoothing reserve during the year (£1.1m balance at 31 March 2020). This reserve continues to be set aside to help mitigate the impact of any future investment income shortfall due to ongoing periods of low interest rates and economic uncertainties weighing down on returns.
- 7.8 Externally Managed Pooled Funds: At 31 March 2020 the Council held investments within the following pooled funds:

Fund	Type	Original Investment	Market Valuation (Mar-19)	Market Valuation (Mar-20)
Fidelity	Multi-Asset Income	£7.5m	£7.7m	£7.0m
Ninety-One (i)	Multi-Asset Income	£7.5m	£7.6m	£6.9m
CCLA	Property	£10.0m	£9.8m	£9.5m
Hermes	Property	£10.0m	£9.5m	£9.3m
Lothbury	Property	£5.0m	£4.7m	£4.5m

(i) Formerly Investec Asset Management; following demerger from Investec Group in March 2020.

- 7.9 An overview of the investment activity in the Council's externally managed pooled funds (including ultra-short dated bond funds) during 2019/20 is shown below:

Fund	Invested (£'m)	Sold (£'m)	Unrealised Gains / Losses(-) (£'m)	Market Valuation 31/03/20 (£'m)	Dividends & Realised Gains (£'000)	Rate of Return (%)
Fidelity	0.0	0.0	-0.7	7.0	338.1	4.51

Ninety-One	0.0	0.0	-0.7	6.9	311.4	4.15
CCLA	0.0	0.0	-0.3	9.5	425.7	4.26
Hermes	0.0	0.0	-0.2	9.3	298.9	2.99
Lothbury	0.0	0.0	-0.2	4.5	147.8	2.96
Federated	24.5	-24.7	0.0	0.0	187.4	0.80

- 7.10 The Council's investments in Property Funds (paragraphs 7.8 and 7.9) are valued on an ongoing basis at the "bid/redemption price"; the price at which units can be sold back to the fund manager. The resulting market valuation of the Council's total externally managed pooled fund investments at 31 March 2020 (£37.2m) is lower than the original invested amount (£40m). This includes a £2.1m unrealised loss at 31 March 2020 as a result of the significant year-end market volatility arising due to the Covid-19 global pandemic (impacting bond markets, equities and commercial property valuations).
- 7.11 Statutory regulations currently in force allow the Council to account for the impact of unrealised pooled fund gains and losses through a Financial Instruments Revaluation reserve held on the Balance Sheet. Whilst these long-term investments remain under review, the Council continues to forecast that when viewed over a long-term (5-year) horizon that capital growth within the individual funds will increase the Council's holding to at least par when compared against the original invested sums.

8. Non-Treasury Investments

- 8.1 A schedule of the Council's non-treasury investments is attached below:

Non-Treasury (Commercial) Activity	£'m
Historic Investment Property (i)	31.1
2 City Park, Hove (Commercial Property)	24.0
Churchill Court, Crawley (Commercial Property)	11.4
Tangmere Solar Farm	10.7
Westhampnett Solar Farm	14.2
Investment Property (as per 2019/20 Balance Sheet)	91.4
Horsham Enterprise Park	13.5
Solar Panels (Installed 2014/15 to 2019/20)	6.5
West Sussex Gigabit (Asset Under Construction)	6.5
Total (31 March 2020)	117.9

(i) As per the Council's 2019/20 Balance Sheet; including smallholdings and other land/properties held for investment return.

- 8.2 During 2019/20 rental income in respect of the Council's investment property (£1.7m) and income generated by solar farms and other Your Energy Sussex schemes (£1.5m) were both recognised in the Council's revenue budgets (as reported in the 2019/20 Statement of Accounts).

9. Resource and Value for Money Implications

Covered in main body of report.

10. Risk Management Implications

Covered in main body of report.

11. Human Rights Act Implications

Not applicable.

12. Crime and Disorder Act Implications

Not applicable.

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Background Papers

None