Performance and Finance Select Committee

9 July 2018

Treasury Management Annual Report 2017/18

Report by Director of Finance, Performance and Procurement

Executive Summary

County Council is required by regulations issued under the Local Government Act 2003 to review an annual treasury management report detailing borrowing and investment activity *(as compared with the approved Treasury Management Strategy)* and actual prudential and treasury indicators for 2017/*18 (as contained within the approved Budget Report)*. The attached treasury management annual report therefore 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).

In accordance with the revised Treasury Management Code of Practice (2017 update) it is proposed the scrutiny of the treasury management annual report is delegated from County Council to the Performance and Finance Select Committee (PFSC); this approach is to be approved by County Council on 20 July and the Council's Financial Regulations will be amended to reflect this change by the Regulation, Audit and Accounts Committee (RAAC) on 23 July 2018.

Additionally, the Treasury Management Panel has reviewed the content of the annual report before submission to PFSC.

Treasury Management Strategy (2017/18)

The Council has substantial amounts of investments and borrowings 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.

Financial risks (including credit and liquidity risks) are minimised through compliance with the annual Treasury Management Strategy, which incorporates the prudential and treasury indicators, approved for 2017/18 by County Council in February 2017.

The procedures for risk management are set out through a legal framework based on the Local Government Act 2003 and the associated regulations (including CIPFA Codes of Practice). The Ministry for Housing, Communities and Local Government's (MHCLG) "Investment Guidance" emphasises the need for investments to focus on security and liquidity, rather than yield. It also recommends that treasury management strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury management advisors.

During 2017/18 the Council complied with all of the 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 2017/18:

- Borrowing: Given the differential between the cost of new Public Works Loan Board (PWLB) borrowing against the return generated on the Council's investments, the use of internal resources in lieu of external borrowing continued to be the most cost effective means of funding 2017/18 capital expenditure (core programme and income generating initiatives). £7m (plus interest) was however repaid to the PWLB as per the terms and conditions of the £70m borrowing taken during April 2011.
- The Treasury Management Strategy allows occasional short-term borrowing to cover day-to-day cash flow shortages. On one occasion during 2017/18 the Council's overdrawn position of its main bank account held with Lloyds exceeded £1m which in accordance with the Treasury Management Strategy represented short-term borrowing for a period of one working day. On all other occasions daily overdrawn balances within the Council's main bank account were met from balances held in the Council's instant access bank accounts and short-term Money Market Funds.
- At 31 March 2018 the Council's PWLB borrowing (external borrowing for capital purposes) was £395.9m (£402.9m at 31 March 2017). Interest payable to PWLB during 2017/18 was £18.1m at an average rate of 4.55%.
- Investments: Security of capital remained the primary objective for all of the Council's internally managed investments; externally managed investments (pooled funds) continued to be approved to help mitigate the effects of low investment returns. The investment strategy was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2017/18. At 31 March 2018 the Council's investments totalled £253.9m (£258m at 31 March 2017). Gross investment interest received during 2017/18 was £2m, representing a return of 0.68% on an average investment portfolio of £291.2m.

WSCC Average Investments	2016/17		2017/18	
	£'m	%	£'m	%
UK Banks: Unsecured Deposits	63.6	22.5	88.6	30.4
UK Banks: Secured Deposits	19.9	7.1	13.4	4.6
Non-UK Banks: Unsecured	58.0	20.6	44.4	15.2
Non-Bank Corporates	7.5	2.7	3.7	1.3
Local Authority	33.4	11.8	59.3	20.4
Money Market Funds	78.5	27.8	56.6	19.4
Externally Managed Pooled Funds	20.9	7.4	25.0	8.6
UK Municipal Bond Agency	0.2	0.1	0.2	0.1
Total	**282.0**	**100.0**	**291.2**	**100.0**

Recommendation
That the Committee reviews, comments on and supports the treasury management annual report.

Treasury Management Annual Report (2017/18)

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 2017/18. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 In accordance with the Code, the Council defines treasury management as: *"The management of the Council's borrowing, 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".*

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the outturn position for the Council's treasury management activities in accordance with policies previously approved by members. The Council's Treasury Management Strategy for 2017/18, originally approved by County Council on 17 February 2017, can be accessed on: http://www2.westsussex.gov.uk/ds/cttee/cc/cc170217i5c.pdf

1.4 The Council confirms that it has complied with the requirement under the Code to give prior scrutiny to the 2017/18 Annual Report by the Treasury Management Panel before being presented to the Performance and Finance Select Committee (Panel meeting dated 14 June 2018). Panel member training on treasury management issues was undertaken during the year on 3 July 2017 in order to support the members' scrutiny role.

2. The Economy and Interest Rates

2.1 During 2017, there was a major shift in financial market expectations in terms of how soon the Bank of England's (BoE) Bank Rate would start on a rising trend. UK economic growth was disappointingly weak in the first half of 2017, mainly due to the sharp increase in inflation caused by the devaluation of sterling after the EU referendum feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently the services sector of the economy, accounting for around 75% of UK Gross Domestic Product (GDP) saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Accordingly there was a significant increase in market expectations that the BoE's Monetary Policy Committee (MPC) would imminently raise the Bank Rate as supported by the minutes of the September 2017 MPC meeting. The November 2017 MPC meeting (alongside the publication of the BoE's quarterly Inflation Report) duly delivered by raising Bank Rate from 0.25% to 0.50%.

2.2 Investment Rates: Following the Bank Rate rise in November 2017, minutes from the February 2018 meeting revealed another sharp hardening in MPC warnings of a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate therefore shifted considerably during the final quarter of 2017/18 and resulted in three to twelve month investment rates increasing sharply during the last two months of the year; as evidenced by the London Interbank Bid Rates (LIBID) 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
01/04/2017		0.25		0.10	0.11	0.13	0.21	0.37	0.59
30/04/2017		0.25		0.10	0.11	0.13	0.20	0.35	0.55
31/05/2017		0.25		0.10	0.11	0.13	0.17	0.31	0.51
30/06/2017		0.25		0.09	0.11	0.13	0.18	0.34	0.56
31/07/2017		0.25		0.10	0.12	0.13	0.16	0.30	0.50
31/08/2017		0.25		0.10	0.11	0.13	0.15	0.28	0.47
30/09/2017		0.25		0.10	0.11	0.13	0.21	0.37	0.60
31/10/2017		0.25		0.10	0.26	0.30	0.33	0.44	0.66
30/11/2017		0.50		0.35	0.36	0.37	0.40	0.47	0.66
31/12/2017		0.50		0.34	0.36	0.37	0.40	0.45	0.64
31/01/2018		0.50		0.35	0.36	0.37	0.40	0.48	0.68
28/02/2018		0.50		0.35	0.36	0.37	0.46	0.57	0.78
31/03/2018		0.50		0.35	0.36	0.39	0.59	0.70	0.88
Minimum		0.25		0.09	0.10	0.12	0.14	0.27	0.46
Average		**0.35**		**0.20**	**0.22**	**0.23**	**0.29**	**0.40**	**0.61**
Maximum		0.50		0.35	0.37	0.39	0.59	0.70	0.88
Spread		0.25		0.26	0.27	0.27	0.45	0.43	0.42

2.3 Borrowing Rates: Public Works Loan Board (PWLB) borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates; as evidenced in the table below (new PWLB maturity loan rates adjusted for 0.20% certainty rate discount available to UK local authorities):

Date	PWLB Notice		1-Year PWLB	5-Year PWLB	10-Year PWLB	20-Year PWLB	25-Year PWLB	50-Year PWLB
01/04/2017	129/17		0.85	1.25	1.93	2.57	2.62	2.37
30/04/2017	164/17		0.82	1.23	1.91	2.57	2.63	2.37
31/05/2017	206/17		0.85	1.17	1.82	2.49	2.54	2.28
30/06/2017	250/17		1.08	1.43	2.06	2.68	2.73	2.46
31/07/2017	292/17		0.98	1.34	2.02	2.66	2.72	2.47
31/08/2017	336/17		0.90	1.22	1.86	2.52	2.58	2.32
30/09/2017	378/17		1.14	1.59	2.18	2.74	2.79	2.52
31/10/2017	422/17		1.17	1.59	2.17	2.73	2.77	2.48
30/11/2017	466/17		1.23	1.66	2.20	2.73	2.77	2.49
31/12/2017	502/17		1.16	1.56	2.06	2.59	2.65	2.38
31/01/2018	044/18		1.33	1.82	2.30	2.71	2.75	2.46

28/02/2018	084/18		1.38	1.90	2.37	2.75	2.77	2.46
31/03/2018	127/18		1.47	1.85	2.23	2.55	2.57	2.29
Minimum			0.80	1.14	1.78	2.46	2.52	2.25
Average			**1.11**	**1.50**	**2.08**	**2.64**	**2.69**	**2.41**
Maximum			1.51	2.01	2.53	2.90	2.93	2.64
Spread			0.71	0.87	0.75	0.44	0.41	0.39

3. Overall Treasury Position

3.1 At the beginning and the end of 2017/18 the Council's actual treasury position (excluding borrowing by PFI and finance leases) was as follows:

	31/03/17 Actual £'m	31/03/18 Actual £'m
Borrowing Requirement	**448.4**	**470.3**
Less: Long-Term Debt (PWLB)	-402.9	-395.9
Less: Short-Term Debt (Non-PWLB) - *Paragraph 3.4*	-4.2	-4.6
Internal Borrowing	**41.3**	**69.8**
Total Investments	**258.0**	**253.9**

3.2 Total investments as reported in paragraph 3.1 (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 to be shown at either amortised cost (inclusive of accrued interest) or at fair value on the Council's Balance Sheet.

3.3 The movement in the Council's internal borrowing during 2017/18 is detailed below:

	£'m
Internal Borrowing (as 31 March 2017)	**41.3**
2017/18 Capital expenditure *(to be funded through borrowing)*	30.5
Repayment of PWLB Debt (EIP Loans)	7.0
Change (increased) Short-Term Debt – *See paragraph 3.4*	-0.4
Revenue Provision for Repayment of Debt	-8.6
Internal Borrowing (as 31 March 2018)	**69.8**

3.4 Throughout 2017/18 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 borrowing on the Council's Balance Sheet as the amount is available for repayment back on any given notice.

4. Treasury Management Strategy (2017/18)

4.1 Throughout 2017/18 the Council complied with all of the relevant statutory and regulatory requirements which require officers to identify and where possible quantify the levels of risk associated with its treasury management activities. No changes were made to the Council's treasury management strategy as originally approved in February 2017.

4.2 Whilst the actual movement in the BoE Bank Rate (and corresponding investment rates) is evidenced in paragraph 2.2, the treasury management strategy was originally approved on the expectation that the Bank Rate would remain at 0.25% throughout 2017/18 and not start rising from this rate until the first quarter of 2019/20 (and then only increasing once more before March 2020). Apart from a small year-end dip at 31 March 2018, a gradual rise in borrowing rates throughout 2017/18 (paragraph 2.3) was in line with the strategy forecasts, with fixed borrowing rates forecast to continue their gradual rise during 2018/19 and 2019/20.

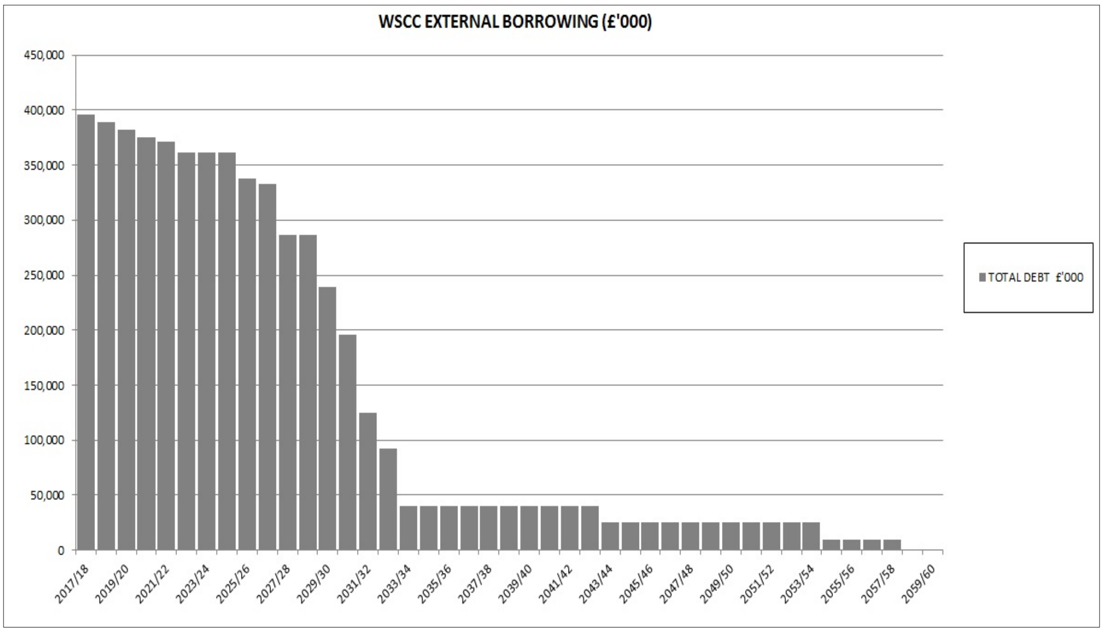
4.3 A cautious approach was maintained regarding internally managed investments throughout 2017/18, whereby investments continued to be dominated by low counterparty risk considerations resulting in relatively low returns throughout the period; investment alternatives however, including externally managed pooled funds, continued to be used to help mitigate the effects of low investment returns. Given the forecast for low investment returns, the treasury management strategy approved deferring external borrowing to future financial years thereby avoiding the additional cost of holding higher levels of investments in 2017/18 (a continuation of the Council's internal borrowing strategy).

4.4 The Council's prudential and treasury indicators (as approved within 2017/18 treasury management strategy; and revised within the 2018/19 treasury management strategy) are reported at Appendix A.

5. Borrowing

5.1 In accordance with the approved treasury management strategy (paragraph 4.3) no new external long-term borrowing for capital purposes was undertaken during 2017/18. £7.0m (plus interest) was however repaid to Public Works Loan Board (PWLB) relating to the £70m borrowing taken during April 2011.

5.2 As a consequence the Council's total external borrowing at 31 March 2018 (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 £395.9m (£402.9m at 31 March 2017) with the following maturity profile:



5.3 Interest payable to the PWLB relating to the Council's long-term borrowing amounted to £18.1m in 2017/18 (£18.3m in 2016/17) representing an average interest rate of 4.55%. If the Council had externalised its internal borrowing on 1 April 2017 (£69.8m; paragraph 3.3) it is estimated that the additional revenue cost in 2017/18 relating to interest payments would have been £1.7m (based on a 50 year PWLB maturity loan at 2.37%; paragraph 2.3).

6. Investments

6.1 The Council's investment policy is governed by MHCLG guidance, which has been implemented in the Council's "Annual Investment Strategy" (as contained within the approved 2017/18 Treasury Management Strategy). This strategy limits the monetary amount and time duration 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).

6.2 In accordance with MHCLG Investment Guidance the security and liquidity of the Council's internally managed investments remained primary investment objectives. 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 must hold a credit rating of A+ or higher). The 2017/18 investment strategy further approved investments in BBB+ rated institutions including the Royal Bank of Scotland (given the part nationalised status of the bank) and non-financial organisations (corporates). The total level of internally managed investments with organisations rated below A- being limited to a maximum of £30m.

6.3 Additionally, UK (and other country) banking legislation places the burden of rescuing failing banks disproportionately onto unsecured creditors (including local authority investors) through the potential bail-in of unsecured bank deposits. The use of unsecured bank deposits and short-term Money Market Funds however remained an integral part of the investment strategy in maintaining adequate cash-flow liquidity as well as enhancing short-term investment returns. In accordance with the approved treasury management strategy, new investments agreed during 2017/18 included:

Non-Bank:

- Short-term investments (up to a maximum of one year) with other UK local authorities: Birmingham City Council, Cambridgeshire County Council, City of Lincoln Council, Dorset County Council, Fife Council, Gloucester City Council, Northamptonshire County Council, Nottingham City Council, Reading Borough Council, Thurrock Borough Council and Transport for London (TfL).
- Fixed Rate bonds with Corporates (assigned a BBB+ credit rating or above): Daimler AG (Germany) and Vodafone Group plc (UK).
- The Council maintained its long-term investments with Lancashire County Council and Wolverhampton City Council (both investments due to mature in the first half of 2019) and in the CCLA Local Authorities Property Fund (investment commenced March 2017; minimum 5-year investment horizon).

Bank Secured:

- Covered fixed-rate bond (short-term) with Yorkshire Building Society.
- The Council continued to hold a long-term covered bond (3-year floating rate note) with Nationwide Building Society (purchased April 2016).

Bank Unsecured:

- Short-term fixed deposits with UK banks: Close Brothers Ltd, Coventry Building Society, Goldman Sachs International Bank and Nationwide Building Society (a 12-month Royal Bank of Scotland certificate of deposit purchased in March 2017 was held until agreed maturity date).
- The Council maintained the deposits held in both the HSBC 3-month notice account and the Lloyds 175-day notice account throughout 2017/18 (additional £5m deposited into the Lloyds notice account during the year).
- Instant access accounts, fixed-term deposits, certificate of deposits and senior unsecured bonds with high credit quality non-UK Banks including: Australia & New Zealand Banking Group and Commonwealth Bank of Australia (Australia); Toronto-Dominion Bank (Canada); United Overseas Bank (Singapore); Svenska Handelsbanken (Sweden); UBS (Switzerland).
- Money Market Funds holding an AAA credit rating, operating a constant net asset valuation and holding underlying assets in excess of £1bn: Aberdeen, Blackrock, Deutsche, Federated (UK), Goldman Sachs, Standard Life and State Street sterling liquidity funds.

Investment Activity in 2017/18	Balance on 1st April (£m)	Investments Made (£m)	Investments Sold (£m)	Balance on 31st March (£m)
UK Banks: Unsecured Deposits	74.5	95.2	-110.0	59.7
UK Banks: Secured Deposits	7.9	10.4	0.0	18.3

Non-UK Banks: Unsecured	30.0	116.9	-87.7	59.2
Non-Bank Corporates	12.2	8.8	-21.0	0.0
Local Authority	54.0	99.8	-100.8	53.0
Money Market Funds	54.9	911.0	-927.1	38.8
UK Municipal Bond Agency	0.2	0.0	0.0	0.2
Total (Exc. Property Funds)	**233.7**	**1,242.1**	**-1,246.6**	**229.2**
Ultra-Short Dated Bond Funds	15.1			15.0
Property Funds	9.2			9.7
Total Investments	**258.0**			**253.9**

6.4 Investments made in 2017/18 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 safe custody arrangements administered by King and Shaxson.

6.5 Credit Risk: In demonstrating compliance against the approved treasury management strategy during 2017/18, the movement in the Council's investment portfolio by the credit rating of the financial institution, or the credit rating of the specific investment (for example covered bond) if higher than the individual counterparty rating, is shown below:

Institution / Investment Credit Rating	2016/17	2017/18			
	31.03.17 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
AAA *(i)*	62.8	59.7	49.3	63.6	57.1
AA	10.0	10.0	0.0	0.0	0.0
AA- *(ii)*	89.0	109.0	91.8	106.0	118.7
A+	0.0	8.5	8.5	8.5	8.5
A	44.5	74.5	74.6	44.6	44.7
A-	12.2	0.0	5.0	0.0	0.0
BBB+	15.0	15.0	15.0	15.0	0.0
Externally Managed Funds	24.3	24.4	24.5	24.7	24.7
UK Municipal Bond Agency	0.2	0.2	0.2	0.2	0.2
Total Investments	**258.0**	**301.3**	**268.9**	**262.6**	**253.9**

(i) Includes short-term Money Market Funds and Covered Bonds.
(ii) Includes all non-rated UK local authorities (assumed AA- rating).

6.6 Furthermore, the 2017/18 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 state. The Council's investment portfolio split by sovereign is shown below:

Deposits by Sovereign	2016/17	2017/18			
	31.03.17 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
Australia	0.0	20.0	30.0	30.0	20.0
Canada	5.0	0.0	0.0	0.0	14.9
Germany	0.0	0.0	5.0	0.0	0.0

Singapore	10.0	0.0	5.0	10.0	10.0
Sweden	15.0	15.0	0.0	0.0	5.8
Switzerland	0.0	8.5	8.5	8.5	8.5
Total (Non-UK)	**30.0**	**43.5**	**48.5**	**48.5**	**59.2**
UK (including Local Authority)	148.6	181.4	164.7	143.9	131.0
Money Market Funds	54.9	51.8	31.0	45.3	38.8
Externally Managed Funds	24.3	24.4	24.5	24.7	24.7
UK Municipal Bond Agency	0.2	0.2	0.2	0.2	0.2
Total Investments	**258.0**	**301.3**	**268.9**	**262.6**	**253.9**

6.7 Counterparty credit quality can be further demonstrated by a benchmarking analysis of the Council's investment portfolio *(excluding the Council's CCLA Property Fund and UK Municipal Bond Agency investments)* undertaken by the Council's treasury management advisor-Link Group (Link Asset Services):

Benchmarking Date: 31 March 2018	**Weighted Average Rate of Return**	**Weighted Average Time to Maturity (days)**	**Weighted Average Total Time (days)**	**Weighted Average Credit Risk**
Link Client Population Average	0.61%	87	184	3.10
English Counties (Link Clients)	0.60%	85	176	2.71
West Sussex County Council	0.69%	133	282	2.62

6.8 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 investment portfolio compares favourably against the average for all Link clients and remains comfortably within their recommended credit risk score range.

6.9 Liquidity Risk: In keeping with MHCLG's Investment Guidance, the Council manages its liquidity position through the setting and approval of prudential and treasury indicators and the approval of the treasury and investment strategy reports. 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 2017/18 is shown below:

Period to Maturity	2016/17	2017/18			
	31.03.17 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
Instant Access Accounts	54.9	51.8	31.0	45.3	44.6
Up to one month	20.0	0.0	60.0	15.0	33.9
One month to 3 months	42.2	75.0	22.8	73.0	40.0
3 months to 6 months	69.5	74.5	62.6	68.5	34.7
6 months to 1 year	23.0	51.5	43.9	12.0	57.9
Greater than 1 year	33.3	33.4	33.5	33.7	27.8

Ultra-Short Dated Bond Fund	15.1	15.1	15.1	15.1	15.0
Total Investments	**258.0**	**301.3**	**268.9**	**262.6**	**253.9**

6.10 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. On one occasion during 2017/18 the Council's overdrawn position of its main bank account held with Lloyds exceeded £1m (£3.9m overdrawn on 25 September 2017) which in accordance with the treasury management strategy represented short-term borrowing for a period of one working day. No charge was incurred as a result of this overdrawn position; as reported to the Regulation, Audit and Accounts Committee within the 2017/18 (Second Quarter) Treasury Management Compliance Report and the Performance and Finance Select Committee within the 2017/18 Mid-Year Report.

7. Investment Performance

7.1 The Council's budgeted investment income as originally approved in the 2017/18 Revenue Budget amounted to £1.6m; reduced from £1.9m in 2016/17 reflecting the expectation that the Bank Rate would remain at 0.25% throughout 2017/18 (paragraph 4.2). The original estimate of 2017/18 gross investment income (before any adjustments for internal/external interest transfers) was £1.8m, based on the assumption that the Council could achieve an average interest rate of 0.77% on an assumed average investment portfolio of £230m. Additionally the investment income budget (as originally reported) included an estimated £0.2m in respect of interest transfers to/from internal and external reserve balances held by the Council.

Investment Income: Original Forecast (February 2017)	£'m
Expected interest receipts on investment portfolio	1.8
Budgeted transfer to/from specific reserves	-0.2
Revenue Budget 2017/18 (Investment Income)	**1.6**

7.2 Throughout 2017/18 the Council maintained average investment balances of £291.2m (£282m in 2016/17). At 31 March 2018 the Council's gross investment income amounted to £2.0m (£1.9m in 2016/17) at an average rate of return of 0.68%. Higher balances available for investment (as compared with the original £230m estimate) were in the main a consequence of the Council holding additional monies on behalf of the Local Enterprise Partnership (LEP) which were not factored into the original investment income forecast.

7.3 At 31 March 2018, £0.4m interest was paid to third parties (including the LEP and Chichester Harbour Conservancy) and other internal balances held by the Council (including PFI reserves and school accumulating funds). As a result the actual performance of investment income throughout 2017/18 as compared against the original Revenue Budget forecast (paragraph 7.1) is summarised below:

	£’m
Expected Interest Receipts on Investment Portfolio	**1.8**
Lower rate of return than assumed budgeted rate (-0.09%)	-0.2
Higher average investment portfolio than budgeted (at 0.77%)	0.4
Actual Interest Received on Investment Portfolio	**2.0**
Interest paid to third parties, internal reserves and LEP	-0.4
Net Interest Received (2017/18)	**1.6**
Revenue Budget 2017/18 (Paragraph 7.1)	1.6
Additional Interest/Shortfall(-)	**0.0**

7.4 The actual interest shortfall at 31 March 2018 (£49,000) was offset by other revenue underspends with no transfer required from the Interest Smoothing reserve (reserve balance at 31 March 2018 totalled £830,000).

7.5 Externally Managed Pooled Funds: At 31 March 2018 the Council held investments within the following pooled funds:

Fund	Type	Rating	Fund Size	Maximum Allowable Investment (31/03/18)	Current Investment *(Market Valuation)*
CCLA	Property	n/a	£976m	£15m	£9.7m
Payden	Ultra-Short Dated Bond	AAA	£383m	£19m	£15.0m

7.6 An overview of the investment activity in the Council’s externally managed pooled funds during 2017/18 is shown below:

Fund	Market Valuation 31-Mar-17	Payments in/out(-)	Market Gain/Loss(-)	Dividends Received	Average Dividend Return
CCLA	£9.2m	£0m	£0.5m	£0.4m	4.47%
Payden	£15.1m	£0m	-£0.1m	£0.1m	0.69%

8. Resource and Value for Money Implications

Covered in main body of report.

9. Risk Management Implications

Covered in main body of report.

10. Human Rights Act Implications

Not applicable.

11. Crime and Disorder Act Implications

Not applicable

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Appendix
A Prudential and Treasury Indicators (Compliance)

Background Papers
None

APPENDIX A

Prudential and Treasury Indicators (Compliance)

1 Gross Debt and the Capital Financing Requirement

1.1 In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external debt does not, except in the short-term if borrowing in advance of need has been approved, exceed the total of the 2017/18 Capital Financing Requirement plus the estimates of any additional Capital Financing Requirement for 2018/19 and the next two financial years; this essentially demonstrates that the Council is not borrowing to support revenue expenditure. The table below shows that at 31 March 2018 the Council's gross external debt has not exceeded its Capital Financing Requirement:

	Original Estimate 2017/18 £'000 *(TMSS-17/18)*	**Revised Estimate 2017/18 £'000 *(TMSS-18/19)***	**Actual 31 Mar 18 £'000**
Capital Expenditure (2017/18)	194,868	116,148	98,027
Capital Financing Requirement	687,647	639,393	575,904
Gross External Debt (including short/long-Term Borrowing, PFI and Finance Leases)	583,910	508,653	506,145

2 Authorised Limit and Operational Boundary for External Debt

2.1 The Authorised Borrowing Limit is a statutory limit determined under Section 3 of the Local Government Act 2003 (referred to in the legislation as the "Affordable Limit"). This limit sets the maximum level of external debt on a gross basis (excluding all investments) for the Council. It is measured on a daily basis against all external debt items on the Council's Balance Sheet, including:

- Long-term borrowing
- Short-term borrowing
- Overdrawn bank balances
- Other long-term liabilities (PFI / Finance Leases)

	Original Estimate 2017/18 £'000 *(TMSS-17/18)*	**Revised Estimate 2017/18 £'000 *(TMSS-18/19)***	**Actual 31 Mar 18 £'000**
External Borrowing (Capital)	660,270	395,866	395,866
External Borrowing (Other)	44,000	44,500	4,623
PFI Schemes & Finance Leases	110,423	108,287	105,656
Authorised Borrowing Limit	814,693	548,653	506,145

2.2 The Operational Boundary (borrowing limit) links directly to the Council's estimates of the Capital Financing Requirement. This indicator is based on the same estimates as the Council's Authorised Borrowing Limit and reflects the maximum borrowing required to meet capital spending plans, without the additional £40m headroom included within the Authorised Limit required in meeting unusual (short-term) cash flow movements.

	Original Estimate 2017/18 £'000 *(TMSS-17/18)*	**Revised Estimate 2017/18 £'000 *(TMSS-17/18)***	**Actual 31 Mar 18 £'000**
External Borrowing (Capital)	469,487	395,866	395,866
External Borrowing (Other)	4,000	4,500	4,623
PFI Schemes & Finance Leases	110,423	108,287	105,656
Operational Borrowing Limit	583,910	508,653	506,145

2.3 Whilst in total the Council confirms that there were no breaches of the Operational and Authorised Borrowing Limits during 2017/18, amounts invested by the Chichester Harbour Conservancy at 31 March 2018 were higher than the Council's original and revised estimates for this external borrowing (other) total. Within the Operational Borrowing Limit the higher than estimated short-term borrowing was offset by technical accounting entries required to the Council's PFI schemes during the final quarter of 2017/18; reducing the associated PFI liability from that originally forecast.

3 Upper Limits for Fixed and Variable Interest Rate Exposure

3.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The Council calculates these limits on the principal outstanding sums as compared with the respective total borrowing and investment levels.

3.2 The upper limits for variable interest rate exposure have been set with regard to current economic forecasts, to ensure that the Council is not exposed to interest rate rises which could adversely impact the revenue budget.

	Approved Limits 2017/18	**Actual Position 31 Mar 18**
Maximum % Borrowing at Fixed Rates	100%	99%
Maximum % Borrowing at Variable Rates	25%	1%
Maximum % Investments at Fixed Rates	100%	58%
Maximum % Investments at Variable Rates	85%	42%

3.3 The Council confirms that there were no breaches of these limits during 2017/18.

4 Maturity Structure of Fixed Rate Borrowing

4.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates, and is designed to protect against excessive exposures to interest rate changes in any one period, in particular over the course of the next ten years.

Treasury Management	**Lower Limit 2017/18 (%)**	**Upper Limit 2017/18 (%)**	**Actual Fixed Rate Borrowing 31 Mar 18 (£'000)**	**Fixed Rate Borrowing 31 Mar 18 (%)**
Over 30 Years	0%	30%	25,000	6%
Over 25 to 30 Years	0%	20%	15,000	4%
Over 20 to 25 Years	0%	15%	0	0%
Over 15 to 20 Years	0%	50%	52,231	13%
Over 10 to 15 Years	0%	60%	194,143	48%
Over 5 to 10 Years	0%	40%	74,913	19%
Over 1 to 5 Years	0%	35%	27,563	7%
Under 12 Months	0%	25%	11,639	3%
			400,489	**100%**

4.2 The Council confirms that there were no breaches of these limits during 2017/18.

5 Upper Limit for Principal Sums Invested over 365 Days

5.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	Upper Limit 2017/18	**Revised Limit *(TMSS-18/19)***	**Actual Position 31 Mar 18**
Maximum invested for longer than a year (£)	£45m	£75m	£33.8m

5.2 The above limit reports on investments with expected maturities in excess of one year on commencement of the investment. This limit may therefore differ to the "greater than one year" investment total shown in paragraph 6.9 of the Annual Report which details the remaining period until actual maturity dates. The Council confirms that there were no breaches of this limit during 2017/18.