Performance and Finance Select Committee
12 July 2019
Treasury Management Annual Report 2018/19
Report by Director of Finance and Support Services

Executive Summary

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 *(as compared with the approved Treasury Management Strategy)* and actual prudential and treasury indicators for 2018/*19 (as contained within the approved Budget Report)*. 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).

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

Treasury Management Strategy (2018/19)

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:

- 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.

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 2018/19 by County Council in December 2017. During 2018/19 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 2018/19:

- Borrowing: The Council continued to fund 2018/19 capital expenditure (core programme and income generating initiatives) through the use of internal resources in lieu of external borrowing ("internal borrowing"). £7m (plus interest) was however repaid to the PWLB as per the terms and conditions of the £70m borrowing taken during April 2011. At 31 March 2019 the Council's PWLB borrowing (external borrowing for capital purposes) was £388.9m (£395.9m at 31 March 2018). Interest payable to PWLB during 2018/19 was £17.8m at an average rate of 4.56%.

- Given the significant borrowing requirement set out in the approved capital programme (up to March 2024) the Council, together with its treasury management advisor (Link Asset Services), is in the process of evaluating the benefits of forward starting commercial loans as an alternative borrowing source to PWLB debt. For such commercial loans borrowing rates are agreed in context with current rates, but funds are drawdown in future periods (typically two to three years), thereby mitigating short-term revenue pressures arising from the differential between borrowing costs incurred and the returns generated on the Council's investments. As at 31 March 2019 however, no such forward starting loans had been approved.

- Additionally, the Council's treasury management strategy allows occasional short-term borrowing to cover day-to-day cash flow shortages. During 2018/19 such occasions 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 2018/19. Security of capital remained the primary objective for all of the Council's internally managed investments. The Director of Finance and Support Services confirms however that during 2018/19 the monetary exposure limit approved for total investments held in short-term Money Market Funds was exceeded for one day; with corrective action being taken on the next working day. Full details were reported to both RAAC on 23 July 2018 *("Treasury Management First Quarter Compliance Report")* and to PFSC on 22 November 2018 *("Treasury Management Mid-Year Review").*

- Externally managed investments (pooled funds) continued to be approved to help mitigate the effects of low investment returns. In accordance with this investment strategy, and following a risk appraisal undertaken in conjunction with Link Asset Services during the first half of 2018/19, the Council invested in additional property and multi-asset income funds thereby increasing its long-term investment exposure to such externally managed pooled funds.

- At 31 March 2019 the Council's investments totalled £204.8m (£253.7m at 31 March 2018). Gross investment interest received during 2018/19 was £3.0m, representing a return of 1.09% on an average investment portfolio of £278.6m.

WSCC Average Investments	2017/18		2018/19	
	£'m	%	£'m	%
UK Banks: Unsecured Deposits	88.6	30.4	57.1	20.5
UK Banks: Secured Deposits	13.4	4.6	8.2	2.9
Non-UK Banks: Unsecured	44.4	15.3	45.4	16.3
Non-Bank Corporates	3.7	1.3	2.2	0.8
Local Authority	59.3	20.4	59.3	21.3
Money Market Funds	56.6	19.4	68.5	24.6
Externally Managed Pooled Funds	25.0	8.6	37.9	13.6
Total	**291.0**	**100.0**	**278.6**	**100.0**

Focus for scrutiny

The Committee is asked to review and comment on the treasury management annual report 2018/19.

Treasury Management Annual Report (2018/19)

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 2018/19. 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 2018/19 *(Section 2)*
- Capital activity during 2018/19 *(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 a)*
- A list of the Council's treasury investments as at 31 March 2019 *(Appendix b)*

1.2 The Council's Treasury Management Strategy for 2018/19, originally approved by County Council on 15 December 2017, can be accessed on: http://www2.westsussex.gov.uk/ds/cttee/cc/cc151217i6f.pdf

2. UK Economy and Interest Rates

2.1 After weak UK economic growth of only 0.1% during the first quarter of 2018, growth subsequently picked up to 0.4% in the second quarter and to a particularly strong 0.7% in the third quarter, before cooling off to 0.2% in the final quarter of 2018. Given ongoing uncertainties regarding Brexit the weak growth reported during the quarter ending 31 December 2018 was to be expected, however some recovery in the rate of growth was forecast going forward (growth is estimated to have risen back to 0.5% during the first quarter of 2019). Annual Gross Domestic Product (GDP) of 1.4% throughout 2018 confirmed the UK as the third fastest growing country in the G7 (Canada, France, Germany, Italy, Japan, the UK and the US).

2.2 UK Consumer Price Index (CPI) inflation had been on a falling trend since peaking at 3.1% in November 2017, reaching a low of 1.8% in January 2019 before rising marginally to 1.9% in February and March 2019 (CPI averaging 2.27% throughout 2018/19). Forecasts published within the Bank of England's February 2019 Inflation Report indicated that over both the two and three year horizons CPI will remain marginally above the MPC's 2% target rate. Concerns remain however in the rising trend in UK wage inflation which peaked at a new post financial crisis high of 3.5% (excluding bonuses) in the three months to December 2018, before falling marginally to 3.3% in the three months to March 2019. British employers ramped up their hiring at the fastest pace in more than three years as the UK labour market defied the broader weakness in the overall economy as Brexit approached, pushing down the UK unemployment rate to 3.8% by the end of March 2019 (its lowest rate since December 1974).

2.3 Against this economic background the Bank of England's Monetary Policy Committee (MPC) raised the UK Bank Rate from 0.5% to 0.75% in August 2018, however it came as little surprise that they abstained from any further increases during the remainder of 2018/19. It remains unlikely that the MPC will take any further action until the uncertainties over Brexit become clear; the next shift in Bank Rate is dependent on the type of exit from the European Union the UK finally delivers.

2.4 <u>Investment Rates</u>: Short-term investment returns (up to 12-month durations) remained low throughout 2018/19. The expectation for interest rates within the Council's 2018/19 treasury management strategy was that the Bank Rate would rise from 0.5% to 0.75% during the third quarter of 2018/19 (one quarter later than the actual change). Up to 31 July 2018 investment rates were on a gently rising trend in anticipation that the Bank of England would raise the Bank Rate in August 2018. It was not expected that the MPC would raise rates again in 2018/19 (given Brexit uncertainties) and accordingly investment rates were changed little between August and October 2018. Three to twelve month investment rates however rose sharply after the November 2018 MPC meeting was unexpectedly hawkish about the perception of building inflationary pressures, particularly from rising wages. Weak GDP growth data for December, plus increasing concerns generated by Brexit, resulted in these rates falling back again; 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
01/04/2018		0.50		0.35	0.36	0.39	0.59	0.70	0.88
30/04/2018		0.50		0.35	0.37	0.39	0.59	0.68	0.85
31/05/2018		0.50		0.35	0.36	0.37	0.49	0.59	0.76
30/06/2018		0.50		0.34	0.36	0.38	0.55	0.66	0.84
31/07/2018		0.50		0.33	0.50	0.56	0.67	0.78	0.93
31/08/2018		0.75		0.58	0.58	0.60	0.68	0.77	0.92
30/09/2018		0.75		0.58	0.59	0.60	0.68	0.78	0.94
31/10/2018		0.75		0.57	0.59	0.60	0.69	0.80	0.93
30/11/2018		0.75		0.56	0.58	0.61	0.77	0.89	1.02
31/12/2018		0.75		0.55	0.58	0.61	0.79	0.91	1.05
31/01/2019		0.75		0.55	0.58	0.61	0.79	0.90	1.04
28/02/2019		0.75		0.55	0.57	0.60	0.73	0.87	1.01
31/03/2019		0.75		0.55	0.57	0.61	0.72	0.83	0.94
Minimum		0.50		0.33	0.35	0.37	0.48	0.59	0.75
Average		**0.67**		**0.49**	**0.51**	**0.54**	**0.68**	**0.79**	**0.94**
Maximum		0.75		0.58	0.59	0.61	0.81	0.92	1.06

2.5 Borrowing Rates: During 2018/19 there was a significant correlation between movements in US Treasury yields and UK Gilt yields, which determine Public Works Loan Board (PWLB) borrowing rates. The US Federal Reserve (the Fed) increased the Fed Rate four times in 2018 (to reach 2.25%-2.50% in December 2018) and gave further guidance that rates could rise by another 1% in the current cycle, causing US Treasury yields to also move up. By the end of December however, financial markets considered that the Fed had gone too far and discounted expectations for further increases; a sharp fall in US Treasury yields has been evident in the first quarter of 2019.

2.6 Regarding PWLB rates in particular, since peaking in October 2018 rates have been on a general downward trend and whilst longer-term rates did spike upwards again in late November and early December, they had fallen back to lows for 2018/19 by late March 2019; 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
01/04/2018	127/18		1.47	1.85	2.23	2.55	2.57	2.29
30/04/2018	167/18		1.43	1.86	2.31	2.66	2.69	2.43
31/05/2018	209/18		1.30	1.71	2.16	2.54	2.56	2.29
30/06/2018	251/18		1.40	1.77	2.18	2.55	2.58	2.35
31/07/2018	295/18		1.46	1.84	2.24	2.60	2.63	2.41
31/08/2018	339/18		1.49	1.83	2.22	2.60	2.63	2.42
30/09/2018	380/18		1.55	1.93	2.33	2.71	2.74	2.56
31/10/2018	426/18		1.52	1.81	2.22	2.65	2.69	2.55

30/11/2018	470/18		1.53	1.73	2.15	2.78	2.87	2.74
31/12/2018	507/18		1.53	1.70	2.08	2.59	2.65	2.50
31/01/2019	044/19		1.54	1.70	2.05	2.51	2.56	2.42
28/02/2019	085/19		1.59	1.76	2.10	2.59	2.64	2.49
31/03/2019	127/19		1.48	1.55	1.85	2.35	2.40	2.23
Minimum			1.28	1.50	1.80	2.28	2.33	2.16
Average			**1.50**	**1.80**	**2.20**	**2.61**	**2.66**	**2.47**
Maximum			1.64	2.07	2.50	2.89	2.93	2.79

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 2018/19 (as compared with the original capital budget approved in December 2017) is shown in the tables below:

	2018/19 Budget £'m	2018/19 Actual £'m
Core Programme	104.4	71.3
Income Generating Initiatives (including Bold Ideas)	31.6	42.6
Total Capital Expenditure	**136.0**	**113.9**

	2018/19 Budget £'m	2018/19 Actual £'m
Capital Receipts	-1.0	-6.8
Government Grants	-69.8	-40.0
External Contributions (including S106)	-9.7	-4.1
Revenue Contributions to capital outlay	-2.3	-4.7
Borrowing (unfinanced capital expenditure)	-53.2	-58.3
Total Financing	**-136.0**	**-113.9**

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

within 2018/19 treasury management strategy; and revised within the 2019/20 treasury management strategy) are reported at **Appendix a**.

4. Overall Treasury Position

4.1 Throughout 2018/19 the Council maintained a cautious approach in regard 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 increased exposure to longer-term externally managed (property and multi-asset income) pooled funds continued to help mitigate the effects of such 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 (a continuation of the Council's internal borrowing strategy).

4.2 At the beginning and the end of 2018/19 the Council's actual treasury position (excluding borrowing by PFI and finance leases) was as follows:

	31/03/18 Actual £'m	31/03/19 Actual £'m
Borrowing Requirement	**470.3**	**519.1**
Less: Long-Term Debt (PWLB)	-395.9	-388.9
Less: Short-Term Debt (Non-PWLB) - *Paragraph 4.5*	-4.6	-4.9
Internal Borrowing	**69.8**	**125.3**
Total Investments	**253.7**	**204.8**

4.3 Total investments as reported in paragraph 4.2 (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.

4.4 The movement in the Council's internal borrowing during 2018/19 is detailed below:

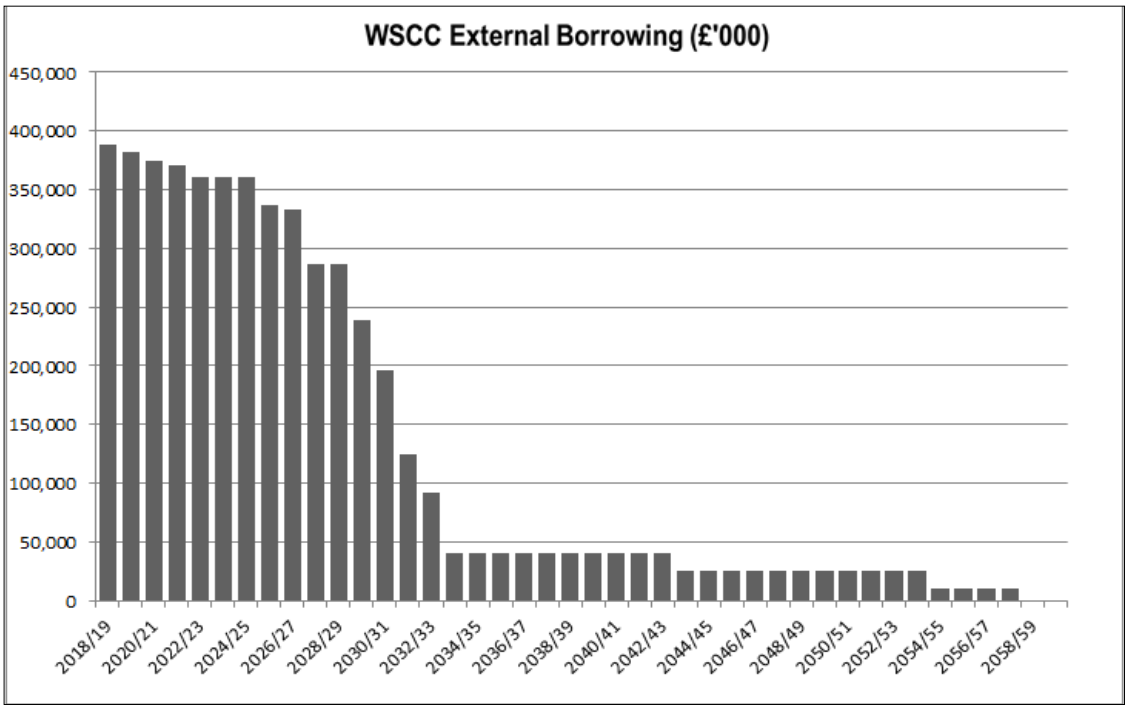
	£'m
Internal Borrowing (as 31 March 2018)	**69.8**
Capital expenditure *(to be funded through borrowing)*	58.3
Repayment of PWLB Debt (EIP Loans)	7.0
Change (increased) Short-Term Debt – *See paragraph 4.5*	-0.3
Revenue Provision for Repayment of Debt	-9.5
Internal Borrowing (as 31 March 2019)	**125.3**

4.5 Throughout 2018/19 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.

5. Borrowing

5.1 In accordance with the Council's approved 2018/19 treasury management strategy no new external long-term borrowing for capital purposes was undertaken during 2018/19. £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 2019 (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 £388.9m (£395.9m at 31 March 2018) with the following maturity profile:



5.3 Interest payable to the PWLB relating to the Council's long-term borrowing amounted to £17.8m in 2018/19 (£18.1m in 2017/18) representing an average interest rate of 4.56%. If the Council had externalised its internal borrowing on 1 April 2018 (£125.3m; paragraphs 4.2 and 4.4) it is estimated that the additional revenue cost in 2018/19 relating to interest payments would have been £2.9m (based on a 50 year PWLB maturity loan at 2.29%; paragraph 2.6).

5.4 Given the significant borrowing requirement set out in the approved capital programme (up to March 2024) the Council is in the process of evaluating forward starting commercial loans as an alternative funding source to the PWLB. For such commercial loans 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 2019 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 2018/19 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 2018/19 investment strategy further approved investments in BBB+ rated corporate (non-bank) organisations up to a maximum duration of 100 days; and the Royal Bank of Scotland (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 and investments with RBS made on an unsecured basis was limited to a maximum of £15m.

6.4 The Director of Finance and Support Services confirms that on one occasion during 2018/19 the monetary exposure limit approved for total investments held in short-term Money Market Funds (£115m) was exceeded (£132.5m on 17 May 2018) due to actual payments and receipts differing from cash flow forecasts; with corrective action being taken on the next working day. Money Market Funds are used to cover the Council's daily liquidity requirements (as opposed to short-term borrowing from other institutions) and the maximum monetary limit approved for all such funds is maintained to ensure that the Council is not over exposed to lower yielding investment products; and is therefore not reflective of any additional credit risk. Full details of this occurrence were reported to the Regulation, Audit and Accounts Committee (23 July 2018) and to this Committee (22 November 2018).

6.5 In accordance with the approved investment strategy, and following a risk appraisal undertaken in conjunction with Link Asset Services during the first half of 2018/19, the Council selected additional property funds (over and above the CCLA Local Authorities' Property Fund) and multi-asset income funds, increasing its long-term investment exposure to externally managed pooled funds. The level of cash considered available for such investments

was based on longer-term forecasts of PFI and other earmarked reserves held by the Council.

6.6 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, investments held during 2018/19 included:

Non-Bank:

- Short-term investments (up to a maximum of one year) with other UK local authorities including: Cambridgeshire County Council, Dorset County Council, Lincoln City Council, Mid Sussex District Council and Northamptonshire County Council.
- Fixed-rate bonds with Corporates (assigned a BBB+ credit rating or above): BP Capital Markets Plc (UK).
- Long-term investments (greater than one year) with other UK local authorities including: Lancashire County Council (maturing April 2019), Plymouth City Council (maturing April 2020) and Wolverhampton City Council (maturing February 2019).

Bank Secured:

- Covered fixed-rate bond (short-term) with Yorkshire Building Society.
- Long-term covered bond (3-year floating rate note) with Nationwide Building Society (maturing April 2019).

Bank Unsecured:

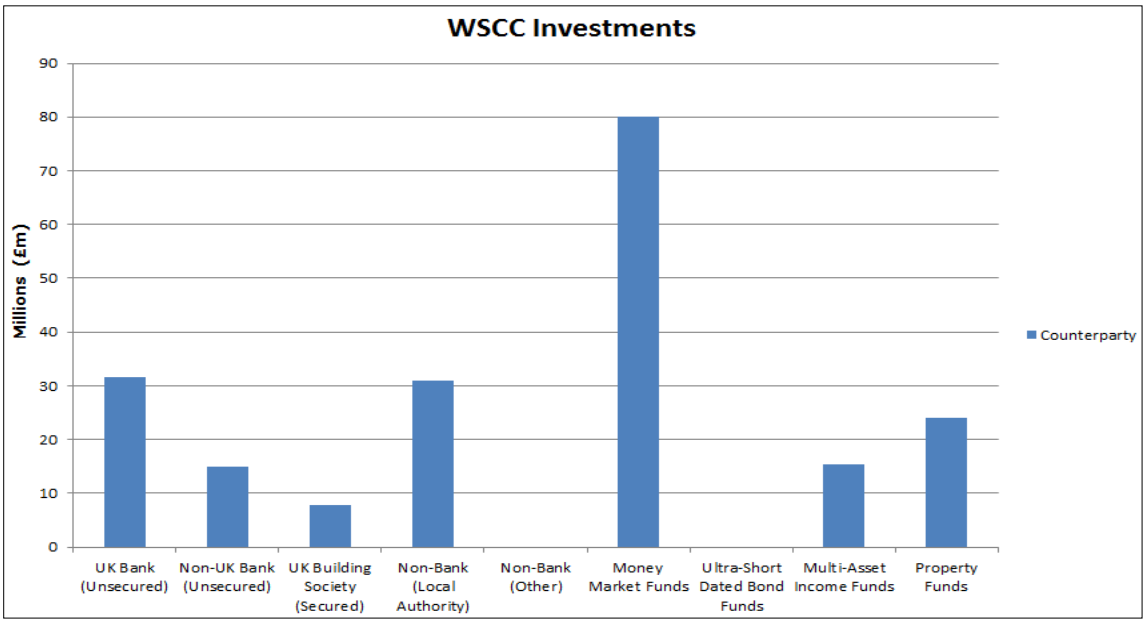
- Certificate of deposits, fixed-term deposits, instant access accounts and notice accounts with UK banks including: Close Brothers Ltd, Goldman Sachs International Bank, Handelsbanken PLC (wholly owned/authorised UK subsidiary from 1 December 2018), HSBC UK Bank Plc, Lloyds Bank Plc, Nationwide Building Society, National Westminster Bank Plc and Standard Chartered Bank.
- Certificate of deposits, fixed-term deposits, instant access accounts, 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); Cooperatieve Rabobank (Netherlands); United Overseas Bank (Singapore); Svenska Handelsbanken (Sweden; see note above) and UBS (Switzerland).
- Money Market Funds holding a AAA credit rating, operating a constant or low volatility net asset valuation and holding underlying assets in excess of £1bn: Aberdeen Standard (following merger with Standard Life), Blackrock, Deutsche, Federated (UK), Goldman Sachs, Standard Life (up to October 2018) and State Street sterling liquidity funds.

Externally Managed (Pooled Funds):

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

6.7 Internally managed investments in 2018/19 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.

6.8 At 31 March 2019 the Council's investments amounted to £204.8m as compared with £253.7m as at 31 March 2018 (including £39.9m Local Enterprise Partnership balances at March 2018; paid over to the new accountable body of the LEP during 2018/19). The full list of the Council's investments held at 31 March 2019 (£204.8m) is shown in **Appendix b**. Additionally a breakdown of the Council's investments by counterparty type at this point in time is shown below:



6.9 At 31 March 2019 the Council was holding significantly higher cash balances in lower yielding instant access Money Market Funds (as shown above) due to the approval to pay-over 2019/20 Local Government Pension Scheme (LGPS) employer contributions as a lump sum payment on 1 April 2019 (£43.2m). As a result of making the lump sum payment, the Council will receive a discounted pension contribution rate which is expected to generate £0.5m revenue savings in 2019/20.

6.10 The cash movement in the Council's internally managed investments during 2018/19 is shown below:

Investment Activity in 2018/19	Balance on 1st April (£m)	Invest-ments Made (£m)	Invest-ments Sold (£m)	Balance on 31st March (£m)
UK Banks: Unsecured Deposits	59.7	103.3	-131.5	31.5
UK Banks: Secured Deposits	18.3	0.0	-10.4	7.9
Non-UK Banks: Unsecured	59.2	121.8	-166.0	15.0
Non-Bank Corporates	0.0	4.5	-4.5	0.0
Local Authority	53.0	21.0	-43.0	31.0
Money Market Funds	38.8	921.1	-879.8	80.1
Total (Exc. Pooled Funds)	**229.0**	**1,171.7**	**-1,235.2**	**165.5**
Multi-Asset Income Funds	0.0			15.3
Property Funds	9.7			24.0
Ultra-Short Dated Bond Funds	15.0			0.0
Total Investments	**253.7**			**204.8**

6.11 Credit Risk: In demonstrating compliance against the approved treasury management strategy during 2018/19, 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	2017/18	2018/19			
	31.03.18 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
AAA *(i)*	57.1	86.7	60.4	31.1	88.0
AA	0.0	0.0	0.0	0.0	0.0
AA- *(ii)*	118.7	137.9	123.0	96.0	47.7
A+	8.5	14.7	14.7	14.7	14.8
A	44.7	55.0	30.0	15.0	0.0
A-	0.0	4.5	4.5	0.0	15.0
Internally Managed	**229.0**	**298.8**	**232.6**	**156.8**	**165.5**
Externally Managed Funds	24.7	34.7	34.0	49.1	39.3
Total Investments	**253.7**	**333.5**	**266.6**	**205.9**	**204.8**

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

6.12 Furthermore, the 2018/19 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	2017/18	2018/19			
	31.03.18 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
Australia	20.0	30.0	25.0	25.0	15.0
Canada	15.0	15.0	10.0	5.0	0.0
Singapore	10.0	10.0	5.0	10.0	0.0
Sweden	5.8	0.0	0.0	0.0	0.0
Switzerland	8.4	0.0	0.0	0.0	0.0
Total (Non-UK)	**59.2**	**55.0**	**40.0**	**40.0**	**15.0**
UK (including Local Authority)	131.0	165.0	140.1	93.6	70.4
Money Market Funds	38.8	78.8	52.5	23.2	80.1
Externally Managed Funds	24.7	34.7	34.0	49.1	39.3
Total Investments	**253.7**	**333.5**	**266.6**	**205.9**	**204.8**

6.13 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 2019	**Weighted Average Rate of Return**	**Weighted Average Time to Maturity (days)**	**Weighted Average Total Time (days)**	**Weighted Average Credit Risk**
Link Client Population Average	0.87%	78	167	2.94
English Counties (Link Clients)	0.92%	70	147	2.69
West Sussex County Council	0.92%	50	236	1.75

6.14 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.

6.15 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 2018/19 is shown below:

Period to Maturity	2017/18	2018/19			
	31.03.18 £'m	30-Jun £'m	30-Sep £'m	31-Dec £'m	31-Mar £'m
Instant Access Accounts	44.6	78.8	52.5	23.2	81.8
Up to one month	33.8	20.0	45.0	25.0	43.9
One month to 3 months	40.0	50.0	31.5	46.0	10.0
3 months to 6 months	34.7	61.2	60.7	47.6	14.8
6 months to 1 year	58.0	78.8	32.9	5.0	5.0
Ultra-Short Dated Bond Fund	15.0	25.0	10.0	10.1	0.0
Greater than 1 year	27.6	19.7	34.0	49.0	49.3
Total Investments	**253.7**	**333.5**	**266.6**	**205.9**	**204.8**

6.16 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 2018/19 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 2018/19 Revenue Budget amounted to £1.9m; increased from £1.6m in 2017/18. The increased revenue budget reflected the move to higher interest rates due to the forecast increase to the UK Bank Rate during 2018/19 (paragraph 2.4) and the approval to increase the Council's exposure to higher yielding (long-term) investments through the use of additional externally managed property and multi-asset income pooled funds (paragraph 6.4).

7.2 The original estimate of 2018/19 gross investment income (before any adjustments for internal interest transfers) was £2.7m, based on the assumption that the Council would achieve an average interest rate of 1% on an assumed investment portfolio of £270m. Additionally, the investment income budget as originally reported included an estimated £0.8m in respect of interest transfers to internal and external reserve balances held by the Council, including Local Enterprise Partnership monies, school accumulating funds, PFI/MRMC reserves and cash held on behalf of the Chichester Harbour Conservancy.

Investment Income: Original Forecast (February 2018)	£'m
Expected interest receipts on investment portfolio	2.7
Budgeted transfer to/from specific reserves	-0.8
Revenue Budget 2018/19 (Investment Income)	**1.9**

7.3 Throughout 2018/19 the Council maintained average investment balances of £278.6m (£291m in 2017/18). At 31 March 2019 the Council's gross investment income amounted to £3.0m (£2.0m in 2017/18) at an average rate of return of 1.09%. 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 2018/19 is shown below:

Investment Type	Average £'m	Interest £'m	Rate of Return
Liquidity	69.6	0.4	0.63%
Short-Term Investments	152.5	1.2	0.81%
Long-Term Investments	56.5	1.4	2.40%
Total	**278.6**	**3.0**	**1.09%**

7.4 In line with original forecasts, £0.8m interest was paid to third parties and other internal balances held by the Council during 2018/19; including brokerage paid in the arrangement of the Hermes and Lothbury property fund investments. As a result the actual performance of investment income throughout 2018/19 as compared against the original Revenue Budget forecast (paragraph 7.2) is summarised below:

	£'m
Expected Interest Receipts on Investment Portfolio	**2.7**
Higher rate of return than assumed budgeted rate (+0.09%)	0.2
Higher average investment portfolio than budgeted (at 1%)	0.1
Actual Interest Received on Investment Portfolio	**3.0**
Interest paid to third parties, internal reserves and LEP	-0.8
Net Interest Received (2018/19)	**2.2**
Revenue Budget 2018/19 (Paragraph 7.1)	1.9
Additional Interest/Shortfall(-)	**0.3**

7.5 The actual interest surplus at 31 March 2019 (£0.3m) was transferred to the Interest Smoothing reserve to help mitigate the impact of any future investment income shortfall due to ongoing periods of low interest rates and economic uncertainties (including Brexit) weighing down on returns. As a consequence, the Interest Smoothing reserve balance at 31 March 2019 totalled £1.1m (£0.8m at 31 March 2018).

7.6 Externally Managed Pooled Funds: At 31 March 2019 the Council held investments within the following pooled funds:

Fund	Type	Original Investment	Market Valuation (31/03/18)	Market Valuation (31/03/19)
Fidelity	Multi-Asset Income	£7.5m	n/a	£7.7m
Investec	Multi-Asset Income	£7.5m	n/a	£7.6m
CCLA	Property	£10.0m	£9.7m	£9.8m
Hermes	Property	£10.0m	n/a	£9.5m
Lothbury	Property	£5.0m	n/a	£4.7m
Federated	Ultra-Short Dated Bond	£10.0m	n/a	Sold
Payden	Ultra-Short Dated Bond	£15.0m	£15.0m	Sold

7.7 An overview of the investment activity in the Council's externally managed pooled funds during 2018/19 is shown below:

Fund	Invested (£'m)	Sold (£'m)	Unrealised Gains / Losses(-) (£'m)	Market Valuation 31/03/19 (£'m)	Dividends & Realised Gains (£'000)	Rate of Return (%)
Fidelity	7.5	0.0	0.2	7.7	91.7	4.02
Investec	7.5	0.0	0.1	7.6	103.0	4.29
CCLA	0.0	0.0	0.1	9.8	426.3	4.26
Hermes	10.0	0.0	-0.5	9.5	188.3	3.18
Lothbury	5.0	0.0	-0.3	4.7	109.8	3.82
Federated	10.0	-10.0	0.0	0.0	69.5	0.79
Payden	0.0	-15.0	0.0	0.0	49.7	0.89

7.8 The Council's investments in Property Funds (paragraphs 7.6 and 7.7) 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 Property Fund investments at 31 March 2019 (£24m) is lower than the original invested amount (£25m). The Council however 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) Investments	Valuation (31/03/19) £'m
Investment Property	
Commercial Property Initiatives (from 2018/19):	
• Churchill Court, Crawley	11.6
• 2 City Park, Hove	22.4
Solar Farms:	
• Tangmere	10.5
• Westhampnett	14.2
Other:	
• Smallholdings (and Farms)	8.6
• Surplus Land (Schools)	7.6
• Tenanted Houses (Residential)	2.3
• Other	2.4
Total (Investment Property classification on the Balance Sheet)	**79.6**
Horsham Enterprise Park *(i)*	16.7
Total (Non-Treasury Investments)	**96.3**

(i) Held as an operational asset on the Balance Sheet as it does not meet the criteria to be classified as an Investment Property, where an asset is held solely for rental income or capital appreciation. No return to-date as the business case to develop the Horsham Enterprise Park is yet to be submitted.

8.2 During 2018/19 rental income in respect of the Council's investment property (£0.4m) and income generated by solar farms and other Your Energy Sussex

schemes (£0.9m) were both recognised in the Council's revenue budgets (as reported in the 2018/19 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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Appendices
a Prudential and Treasury Indicators
b Counterparty Investments

Background Papers
None