Item: 7.1

Policy and Resources Committee: 26 November 2019.

Treasury Management – Annual Report.

Report by Head of Finance.

1. Purpose of Report

To report on the performance of the treasury management function for financial year ended 31 March 2019.

2. Recommendations

The Committee is invited to note:

2.1.

That the Bank of England Base Rate increased to 0.75% on 2 August 2018, with the Public Works Loans Board borrowing rates increasing correspondingly, with shorter term rates increasing more sharply than longer term rates.

2.2.

That, although there remains much uncertainty over interest rates, with the long-term trend prediction for rates to rise, the Council should be well placed to benefit from savings on loan charges over the longer term.

The Committee is invited to scrutinise:

2.3.

The Annual Treasury Management Review for financial year 2018 to 2019, attached as Appendix 1 to this report, in order to obtain assurance that the Treasury Management Practices have operated effectively.

3. Background

3.1.

Section 21 of the Financial Regulations confirms that the Council has adopted the key recommendations of Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Sector Code of Practice (the Code).

3.2.

The revised Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management in the Public Services (2011) further expands the definition of treasury management to include investment activities.

3.3.

The Council's investment priorities can be summarised as maintaining:

- The security of capital.
- The liquidity of its investments.

3.4.

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments. This is in keeping with the nature of the Strategic Reserve Fund, which is to provide for the benefit of Orkney and its inhabitants, whilst having regard to the Fund's long term obligations in terms of the decline and decommissioning of the Flotta Oil Terminal in the future.

3.5.

The Financial Regulations refer to maintenance of the Treasury Management Policy Statement and Treasury Management Practices as the cornerstone for effective treasury management and the requirement to report annually on the Treasury Management function.

4. Treasury Management Performance

4.1.

A detailed analysis of the Treasury Management Performance for financial year 2018 to 2019 is attached as Appendix 1 to this report, and refers to the following activities:

- Capital Expenditure and Financing.
- The Council's Overall Borrowing Need.
- Treasury Position as at 31 March 2019.
- The Strategy for financial year 2018 to 2019.
- Borrowing Outturn.
- Investment Outturn.
- Other Issues.

4.2.

The conclusion of the analysis of performance is that existing treasury management practices have operated effectively over the previous financial year.

4.3.

Slippage on the approved capital programme for financial year 2017 to 2018 of £11,207,000 into financial year 2018 to 2019 and then further re-profiling of £14,370,000 from financial year 2018 to 2019, and beyond, has delayed the timescale over which the capital finance is required.

4.4.

The Council has established an authorised limit for external debt of £75,000,000 for the three-year period 2018 to 2021, together with an operational boundary of £60,000,000, as part of its Treasury Management Strategy for 2018 to 2019.

4.5.

The Council supports its capital financing requirement through a combination of borrowings and use of internal reserves. In determining this combination, the cost of raising additional finance or borrowing is compared against the opportunity cost of using internal reserves and balances, in that these funds could otherwise be generating an investment return for the Council. On the basis the capital financing requirement can be externalised through borrowings, and investment returns generated in excess of the cost of any borrowings to meet the requirements of the capital programme, the potential exists for a net saving to be realised by the treasury management function over the longer term.

4.6.

As at 31 March 2019, the Council's debt portfolio stood at £30,171,150, with loan maturities ranging over periods from one to 46 years. Overall this represents an average cost of borrowing of 3.82% per annum, with an average duration of 36.6 years.

4.7.

The cost of this debt is managed as part of the loan charges associated with the capital programme and has been offset in the short term with surplus funds placed on deposit for periods of up to one year at an average rate of 0.85% for financial year 2018 to 2019.

4.8.

The Bank of England Base Rate increased to 0.75% on 2 August 2018, with the Public Works Loans Board borrowing rates increasing correspondingly, with shorter term rates increasing more sharply than longer term rates.

4.9.

Although there remains much uncertainty over interest rates, with the long-term trend prediction for rates to rise, the Council should be well placed to benefit from savings on loan charges over the longer term.

4.10.

The prime objective for the managed funds remains to maintain or increase their real value over time, while at the same time generating an annual return which meets the targets set by the Council. These objectives normally require to be measured over a number of years while acknowledging that abnormal fluctuations in the short term do create a cause for concern.

4.11.

During financial year 2018 to 2019 a strategy review was taking place with a number of strategies being identified depending on whether the objective or focus of the Strategic Reserve Fund managed fund investments is to achieve growth or income generation going forward.

4.12.

The Head of Finance, in consultation with Hymans Robertson, developed the findings of the strategy review into a set of specific proposals and, on 28 February 2019, the Investments Sub-committee resolved to further diversify into Illiquid Debt and Secured Income by way of direct investment to a pooled fund. The Sub-committee further resolved that the equity allocation be split on a 50/50 basis between funds held on a growth bias, with a newly appointed Fund Manager, whilst retaining the existing fund manager on a simplified single global equity strategy with the existing value style bias. The Corporate Bonds allocation will be transferred to a specialist passive manager. These diversifications will be matched by a proportionate reduction in growth assets, along with the existing Bonds allocation.

4.13.

The Head of Finance developed an Action Plan, in consultation with Hymans Robertson, to commence the process of implementation of the changes to the investment strategy. Interviews with potential fund managers took place in August and October 2019.

5. Corporate Governance

This report relates to the Council complying with its governance and financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

6. Financial Implications

The financial implications are contained within the body of the report.

7. Legal Aspects

7.1.

Treasury Management arrangements help the Council meet its statutory obligation to secure best value.

7.2.

Section 40 of the Local Government in Scotland Act 2003 provides local authorities with the power to invest money. This power may be exercised in accordance with regulations made by Scottish Ministers under this section.

7.3.

Section 95 of the Local Government Act 1973 states that every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for the administration of those affairs.

8. Contact Officers

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9. Appendix

Appendix 1: Annual Treasury Management Review for financial year 2018 to 2019.

Annual Treasury Management Review

2018/19

Orkney Islands Council

ABBREVIATIONS USED IN THIS REPORT

LAS: Link Asset Services, Treasury solutions – the council's treasury management advisers.

CE: Capital Economics - is the economics consultancy that provides Link Asset Services, Treasury solutions, with independent economic forecasts, briefings and research.

CFR: capital financing requirement - the council's annual underlying borrowing need to finance capital expenditure and a measure of the council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone
EU: European Union
EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing policy. It is composed of 12 members--the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies--the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom--that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e. a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

LIBID: the London Interbank Bid Rate is the rate bid by banks on deposits i.e., the rate at which a bank is willing to borrow from other banks. It is the "other end" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend).

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing.

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e. not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to 'cool' the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – CPI. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the full council before the start of each financial year.

Annual Treasury Management Review 2018/19

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2018/19. 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).

During 2018/19 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Policy and Resources Committee Council 20/02/2018)
- a mid-year (minimum) treasury update report (Policy and Resources Committee 27/11/2018)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Policy and Resources Committee before they were reported to the full Council.

2. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), 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.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	2017/18 Actual	2018/19 Budget	2018/19 Actual
Capital expenditure	**14.760**	**29.618**	**15.083**
Financed in year	11.876	12.257	11.893
Unfinanced capital expenditure	**2.884**	**17.361**	**3.190**

3. The Council's Overall Borrowing Need

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

Gross borrowing and the CFR - 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 borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2018 Actual	31 March 2019 Budget	31 March 2019 Actual
CFR (£m)	47.704	52.392	46.255
Gross borrowing position	30.200	30.171	30.171
Under / over funding of CFR	17.504	22.221	16.084

The authorised limit - this Council has kept within its authorised external borrowing limit as shown by the table below.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2018/19
Authorised limit	£75.000m
Maximum gross borrowing position during the year	£48.256m
Operational boundary	£60.000m
Financing costs as a proportion of net revenue stream	1.8%

4. Treasury Position as at 31 March 2019

At the beginning and the end of 2018/19 the Council's treasury position was as follows:

DEBT PORTFOLIO	31 March 2018 Principal	Rate/ Return	Average Life years	31 March 2019 Principal		Rate/ Return	Average Life years
Fixed rate funding:							
-PWLB	£30.000m			£30.000m			
-Salix Finance Ltd	£0.200m			£0.171m	£30.171m		
Total debt	**£30.200m**	**3.82%**	**30.32**		**£30.171m**	**3.82%**	**29.34**
CFR	**£47.704m**				**£48.256m**		
Over / (under) borrowing	**£17.504m**				**£18.085m**		
Total investments	**£28.699m**				**£34.142m**		
Net debt	**£1.501m**				**(£3.971m)**		

The maturity structure of the debt portfolio was as follows:

	31 March 2018 actual	31 March 2019 actual
Under 12 months	£0.029m	£5.029m
12 months and within 24 months	£5.029m	£0.029m
24 months and within 5 years	£5.087m	£5.087m
5 years and within 10 years	£0.055m	£0.026m
10 years and within 40 years	£0.000m	£0.000m
40 years and within 50 years	£20.000m	£20.000m

INVESTMENT PORTFOLIO	Actual 31.3.18 £m	Actual 31.3.18 %	Actual 31.3.19 £000	Actual 31.3.19 %
Treasury investments				
Banks	12.199	5.00	13.442	5.23
Building Societies - rated	0.000	0.00	0.000	0.00
Local authorities	11.000	4.51	10.000	3.90
Money Market Funds	3.500	1.43	2.700	1.05
Certificate of Deposit – UK Banks	2.000	0.82	8.000	3.11
Total managed in house	**28.699**	**11.76**	**34.142**	**13.29**
Equity funds	88.464	36.24	91.548	35.63
Bond funds	47.915	19.63	49.667	19.33
Property funds	21.422	8.77	22.402	8.72
Diversified Growth Fund	37.366	15.31	38.522	15.00
Credit Strategies Fund	20.236	8.29	20.628	8.03
Total Strategic Reserve Fund managed externally	**215.403**	**88.24**	**222.767**	**86.71**
TOTAL TREASURY INVESTMENTS	**244.102**	**100%**	**256.909**	**100%**
Non- Treasury Strategic Reserve Fund investments managed in house				
Fishing Quota	2.455	34.23	2.688	43.90
Private Companies	4.704	65.59	3.421	55.89
Other	0.013	0.18	0.013	0.21
TOTAL NON-TREASURY INVESTMENTS	**7.172**	**100%**	**6.122**	**100%**
Treasury investments (in-house)	**28.699**	**11.42**	**34.142**	**12.98**
Managed Fund investments (external)	**215.403**	**85.73**	**222.767**	**84.69**
Non-Treasury investments	**7.172**	**2.85**	**6.122**	**2.33**
TOTAL OF ALL INVESTMENTS	**251.274**	**100%**	**263.031**	**100%**

5. The strategy for 2018/19

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations.
Bank Rate was forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends when the strategy was being prepared were:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

Therefore the suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year was as follows:

	Now
2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	1.75%
2023/24	2.00%
Later years	2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits were set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

The Council approved the treasury indicator and limit below, with respect to the allocation to the UK Property fund mandate, as part of the Strategic Reserve Fund managed funds:

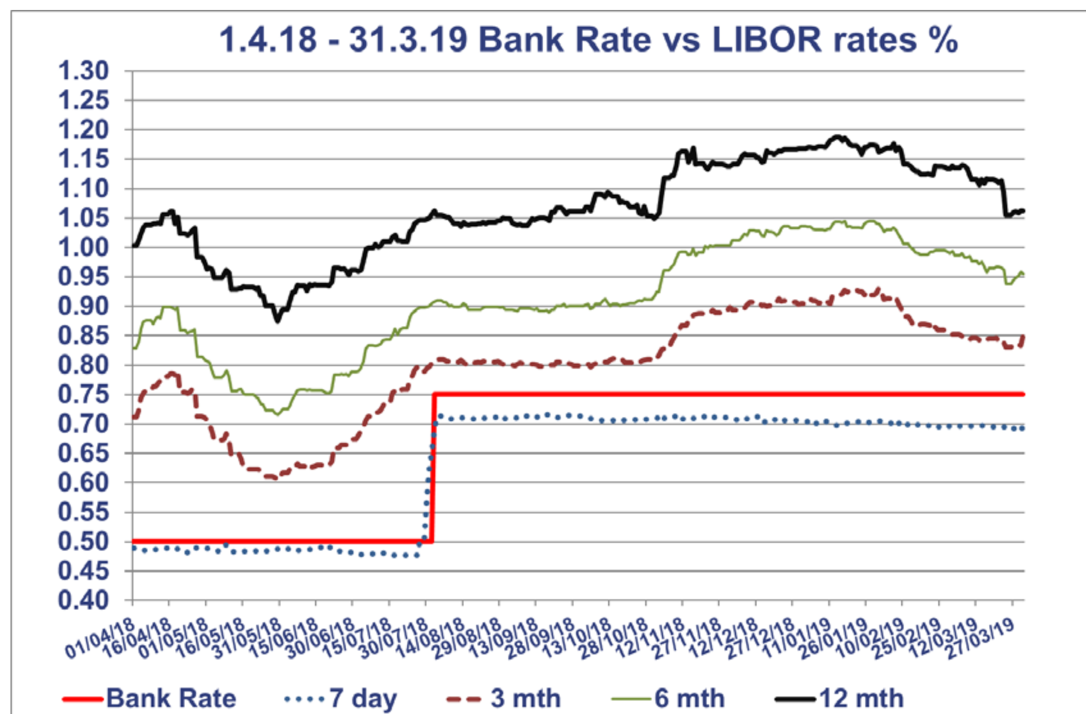
Maximum principal sums invested > 364 & 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 364 & 365 days	£20m	£20m	£20m

The budgeted investment earnings rates for returns on the Council's strategic reserve fund investments is derived from the approved investment strategy for the portfolio of investments that are managed by appointed external fund managers. When the strategy was prepared the investment returns were forecast as follows:

- 2017/18 5.60%
- 2018/19 5.60%
- 2019/20 5.60%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

5.1 Investment strategy and control of interest rate risk



Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5.2 Borrowing strategy and control of interest rate risk

During 2018/19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

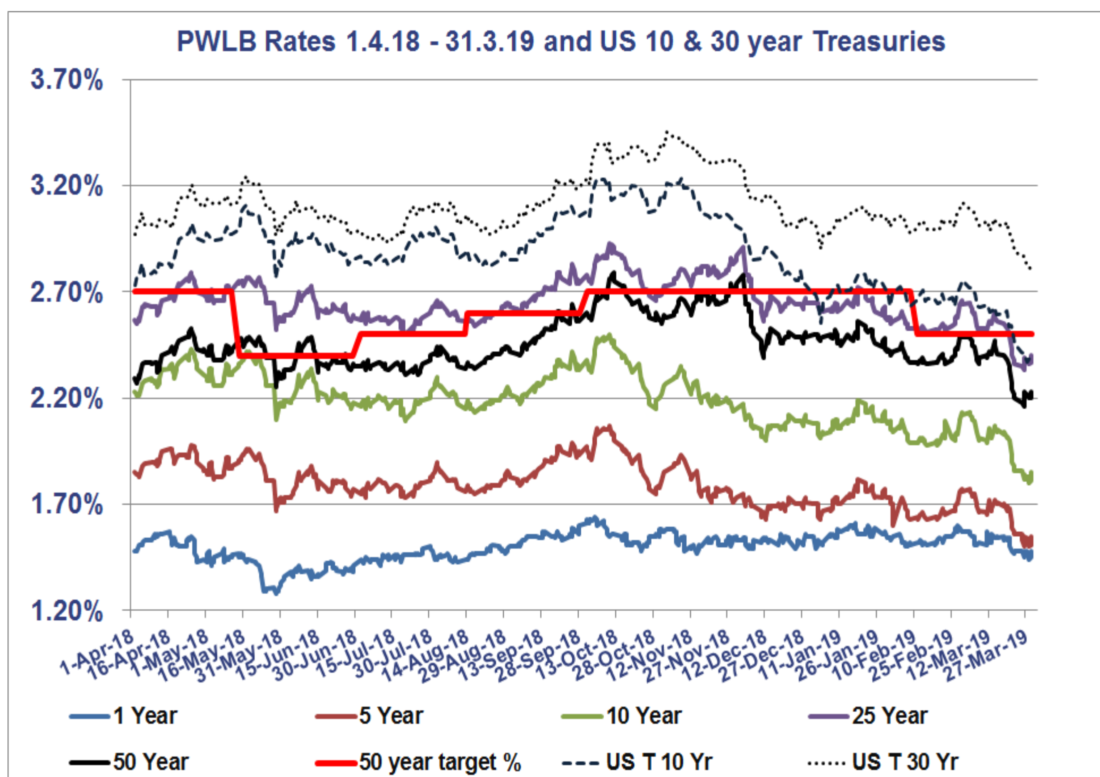
Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks*:*

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.

- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

Interest rate forecasts at that time expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View	12.2.18												
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields - which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

6. Borrowing Outturn

Borrowing – no new loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt during 2018/19 with the capital debt reducing by £0.029M to £30.171M.

The loans outstanding at 31 March 2019 were:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£5.000m	Fixed interest rate	3.51%	26/05/2019
PWLB	£5.000m	Fixed interest rate	3.93%	26/05/2022
PWLB	£10.000m	Fixed interest rate	4.28%	26/05/2060
PWLB	£10.000m	Fixed interest rate	3.54%	10/10/2064
Salix Finance Ltd	£0.171m	Interest free	0.00%	Equal Instalment of Principal – 7 years remaining
TOTAL	£30.171m	Average rate	3.82%	

Borrowing in advance of need
The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Repayments
During 2018/19 the Council repaid £0.029m being the first equal instalment of principal on the 8-year interest free loan from Salix Finance Ltd.

7. Investment Outturn

Investment Policy – the Council's investment policy is governed by investment regulations which have been implemented in the annual investment strategy approved by the Council on 20/02/2018. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£m)	31 March 2018	31 March 2019
Fund balances/reserves – managed in-house	33.880	38.769
Strategic Reserve Fund – externally managed	215.403	222.767
Capital Receipts	2.630	2.555
Provisions	2.802	0.000
Other	8.585	9.739
Total	**263.300**	**273.830**

Investments managed in-house by the Council

- The Council maintained an average balance of £33.997m of internally managed funds.
- The internally managed funds earned an average rate of return of 0.85%.
- The comparable performance indicator is the 90-day LIBOR rate, which was 0.80%.
- Total investment income was £0.289m.

Investments managed by external fund managers

The Council employs specialist external fund managers to invest Strategic Reserve Fund cash balances across five separate mandates. The performance of the managers compared against the benchmark return for the 12 months ending 31 March 2019 was:

Mandate	Investments Held	Return	Benchmark
Equities Portfolio	£91.548m	8.1%	8.8 %
UK Property Fund	£22.402m	5.9%	4.8%
Dynamic Diversified Growth Fund	£38.522m	3.7%	0.8%
Global High Yield Credit Strategies Fund	£20.628m	2.6%	0.8%
Fixed Income Fund	£49.667m	4.0%	3.8%
Total	£222.767m	5.7%	5.2%

This compares with a budget assumption of 5.6% investment return. Performance during the year has been good in absolute terms with performance ahead of benchmark by 0.5%.

The performance of investment mandates, including that of the Fund Managers, is measured against targets to out-perform the respective benchmarks over rolling 3 year periods and in some cases this has not been met, as follows:

Mandate	Benchmark	Target	Target Return	Actual Return
Equities Portfolio	45% FTSE All Share 55% MSCIAC World	+1.5% p.a. over rolling 3 years	13.8%	11.9 %
UK Property Fund	MSCI All Balanced Property	Outperform benchmark	6.1%	7.2%
Dynamic Diversified Growth Fund	3 month LIBOR	+3% net of fees	3.6%	4.0%
Global High Yield Credit Strategies Fund	3 month LIBOR	+ 5% gross	5.6%	2.7% (with effect from Aug 2017)

Fixed Income Fund	ML Non-Gilts All Stocks	+0.75% over 3 years	5.1%	5.0%

8. Other Issues

The Authority's activities expose it to a variety of financial risks:

- credit risk – the possibility that other parties might fail to pay amounts due to the Authority.
- liquidity risk – the possibility that the Authority might not have funds available to meet its commitments to make payments.
- market risk – the possibility that financial loss might arise for the Authority as a result of changes in such measures as interest rates and stock market movements.

The Council's management of treasury risks actively works to minimise the Council's exposure to the unpredictability of financial markets and to protect the financial resources available to fund services. The Council has fully adopted CIPFA's Code of Treasury Management Practices and has written principles for overall risk management as well as written policies and procedures covering specific areas such as credit risk, liquidity risk and market risk.

Credit Risk
Credit risk arises from the short-term lending of surplus funds to financial institutions and local authorities, as well as credit exposures to the council's customers.
The risk is minimised through the Annual Investment Strategy.

Credit Risk Management Practices
The Council's credit risk management practices are set out on pages 43 to 48 of the Annual Investment Strategy. It is the policy of the council to place deposits only with a limited number of high quality banks, building societies and money market funds whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers and to restrict lending to a prudent maximum amount for each entity.

Deposits are not made with banks and financial institutions unless they are rated independently with minimum score of A1/P1/F1 short term debt ratings with Moodys, Standard & Poors or Fitch. The authority has a policy of not lending more than £10M of its surplus balances to individual institutions at any one time.

No credit limits were exceeded during the financial year 2018/19 and the Council expects full repayment on the due date of deposits placed with its counterparties.

Liquidity risk
The authority has a cash flow management system that seeks to ensure that cash is available as needed. If unexpected movements happen, the authority has ready access to borrowings from the money markets and the Public Works Loans Board. There is no significant risk that it will be unable to raise finance to meet its commitments under financial instruments. Instead, the risk is that the authority will be bound to replenish a significant proportion of its borrowings at a time of unfavourable interest rates. The authority sets limits on the proportion of its fixed rate borrowing during specified periods.

Market risk: interest rate risk
The Authority is exposed to risk in terms of its exposure to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the authority. For instance, a rise in interest rates would have the following effects:

- borrowings at variable rates – the interest expense charged to the Surplus or Deficit on the Provision of Services will rise.
- borrowings at fixed rates – the fair value of the liabilities borrowings will fall.
- investments at variable rates – the interest income credited to the Surplus or Deficit on the Provision of Services will rise.
- investments at fixed rates – the fair value of the assets will fall.

The authority's investment strategy aims to manage interest rate risk by maintaining a number of discrete investment mandates or portfolios which are managed by specialist external fund managers. The diversification across equities, multi-asset pooled funds and bond investments in this way effectively minimises the Council's exposure to interest rate movements. The risk of loss remains with the authority.

Market risk: price risk
The authority held £228.889M of investments as at 31 March 2019 in the form of equities, multi-asset pooled funds and bonds, including £2.979M in a local wind energy company and £2.688M in fishing quota. The authority is consequently exposed to losses arising from movement in the price of the shares.

The authority's investment strategy limits its exposure to price movements by diversifying its investment portfolio through the use of external fund managers, investment guidelines, benchmarks and targets.

These clearly defined shares are mainly classified as Fair Value through Profit or Loss with the investment in the local wind energy company and fishing quota classified as Fair Value Other Comprehensive Income, meaning that all movements in price will impact directly on the Surplus or Deficit in the Provision of Services.