Appendix 2

Treasury Management (TM) Update Report

1 Changes in the external environment

Economic Outlook

1.1 Over the past few weeks we have seen sharp movements in market signals driven by deteriorating global growth prospects, especially in the Eurozone. Many of the international leading economic indicators have started to flash warnings of a period of instability ahead.

1.2 There is political uncertainty regarding the outcome of the forthcoming presidential election in Greece which could increase the prospects of a Greek exit from the Eurozone. The collapse in crude oil prices is also continuing and the combined effect of these factors is causing volatility in stock markets around the world.

2 Investment Strategy

2.1 As a result of the increased risks, we felt it was prudent to make a number of amendments to our strategy as highlighted below. These amendments were approved by full Council in November 2014.

Bank Deposits

2.2 Conventional bank deposits will become riskier during 2015/16 because of a lower likelihood that the UK and other governments will support failing banks in the future. As the Banking Reform Act 2014 is implemented in the UK from January 2015, banks will no longer be able to rely on government bail-outs if they get into difficulty. They will be required instead to bail themselves out by taking a proportion of investors' deposits to build up their capital. This new risk has been termed 'bail-in' risk and is potentially a greater risk to investors than the 'bail-out' risk of the past.

2.3 There are many investors such as companies and charities which will be protected but local authorities' deposits will not be eligible for protection because public authorities have much better access to credit than citizens.

2.4 As a result of the removal of government support, there is a risk of major UK banks being downgraded to the "BBB" category which was lower than DCC's acceptable minimum credit rating of "A-". This meant that we amended our Treasury Management Strategy Statement (TMSS) to allow investment in lower rated banks to ensure that we can continue to invest in the major UK banks should they be downgraded.

2.5 It was also prudent to reduce our duration limits for unsecured bank and building society investments from 1 year to 6 months in most cases. The only exception to this was the Barclays Bank limit which was reduced further to 100 days.

Reverse Repurchase Agreements (REPOs)

2.6 These involve the purchase of a security (usually bonds, gilts or other government securities) tied to an agreement to sell it back later at a pre-determined date and price. REPOs provide protection through the ownership of collateral in the form of securities which is significantly more secure than investing in unsecured bank deposits. (The glossary in Appendix 1 provides definitions of the various treasury terms used)

2.7 These are therefore secured investments with banks which are exempt from bail-in risk so they offer a safer alternative at similar rates to unsecured bank deposits. We amended the TMSS to include REPOS in the list of approved investment instruments.

2.8 It is likely that we will begin to use these investments from April 2015 and the minimum investment amount is likely to be £10m.

Covered Bonds

2.8 These are also secured investments with banks which are exempt from bail-in risk and they offer a secure option for our long term investments. We amended the TMSS to include the word ‘securities’ within the table on Approved Investment Counterparties to ensure that we could use covered bonds.

2.9 The Council has also been investing with the UK Government’s Debt Management Office and other local authorities and this option has been used when safe limits have been reached with financial institutions.

3 Borrowing Strategy

3.1 Following the loans we undertook in February / March 2014, it was anticipated that rates would increase. The rates remained low however and we took advantage of this in August by taking out a new loan for £10m at a rate of 3.5% over a 23.5 year period on an Equal Instalment of Principal (EIP) basis.

3.2 This action was taken as the Corporate Plan is now progressing so we will be using our reserves. Borrowing rates are expected to rise at some point so we will continue to monitor interest rates throughout the year to ensure that we undertake further borrowing if required at the most advantageous time.

3.3 Although this will create a cost of carry while the proceeds are temporarily held as investments, we will save in the long term because of the anticipated increase in borrowing rates which will result in higher interest costs. For example, a 1% increase in the rates would cost us approximately £1.2m more in interest based on the example above of a £10m loan over a 23.5 year period.

4 Controls

4.1 Prudential Indicators

The Council sets prudential indicators which set boundaries within which our treasury management activity operates. The indicators are calculated to demonstrate that the Council's borrowing is affordable and include measures that show the impact of capital and borrowing decisions over the medium term. The Council has remained within all of its borrowing and investment limits for 2014/15 agreed by Council in February 2014. The Council has not deviated from the Capital related indicators either.

4.2 Audit Reviews

Following a positive internal audit review in February 2014, the next audit review will be undertaken in February 2015.

5 Future

5.1 Housing Revenue Account Subsidy Reform

The Welsh Government has concluded negotiations with HM Treasury regarding the reform of the HRA subsidy system in Wales. We will need to borrow between £39m and £55m on 02/04/15 to buy ourselves out of the subsidy scheme to become self-financing.

5.2 TM Strategy for next six months

As stated above, we will be borrowing between £39m and £55m on 02/04/15 for the HRA buy-out. As the Corporate Plan is progressing, we will continue to review our cash position to ensure that we undertake further borrowing if required. The Council will also monitor market conditions and interest rate levels to ensure that external borrowing is undertaken at the optimal time in line with our TM strategy.

5.3 Private Finance Initiative (PFI)

The Council has a PFI scheme which is shown on the Balance Sheet at a value of £10m. We are currently reviewing the TM implications of the scheme.

5.4 Reports

The next reports will be the annual TM Report 2014/15 and the TM Update Report 2015/16 which will be reported to the Corporate Governance Committee in September.