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 volatility in financial markets as fears over the Greek debt crisis continued and in response to the news more recently regarding the slow-down in economic growth in China. The European Central Bank (ECB) has downgraded its growth and inflation outlook in response to the turbulence in China's financial markets which is a reminder of the emerging economic consequences of globalisation.

2 Investment Strategy

2.1 As a result of the increased risks, we felt it was prudent to amend our investment strategy in February 2015 for 2015/16 in order to reduce our dependence on conventional bank deposits as highlighted below.

Unsecured Bank Deposits

2.2 Conventional bank deposits became riskier during 2014/15 because of a lower likelihood that the UK and other governments would support failing banks. As the Banking Reform Act 2014 was implemented in the UK from January 2015, banks were no longer able to rely on government bail-outs if they got into difficulty. They would 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 were many investors such as companies and charities which were protected but local authorities' deposits were not eligible for protection because public authorities have much better access to credit than citizens.

2.4 As a result of the increased risks, the Council has been placing a far greater emphasis on investing with the UK Government's Debt Management Office and other local authorities in order to minimise these risks.

Secured Investment Options

2.5 The Council also included secured investment options within its investment strategy such as those described below with a view to using them during 2015/16.

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. 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.

2.7 There have been delays with the implementation of REPOs for local authorities because of legal formalities but these are expected to be resolved soon so they should be available as a safer investment alternative in the near future.

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.

(The glossary in Appendix 1 Annex C provides definitions of the various treasury terms used)

3 Borrowing Strategy

3.1 The Welsh Government concluded negotiations earlier this year with HM Treasury regarding the reform of the HRA subsidy system in Wales. We borrowed £40m from the Public Works Loan Board (PWLB) on 02/04/15 to buy ourselves out of the subsidy scheme to become self-financing.

3.2 We also terminated the PFI contract on the Council offices in Ruthin on 04/09/15 and as planned, we used a significant proportion of our investment balances to achieve this by buying ourselves out of the PFI agreement. The termination will save the council a considerable amount of money and provide greater flexibility in the use of the assets covered by the PFI agreement. As a result of this, we still have sufficient cash to cover our monthly outgoings and we can also access temporary borrowing from other local authorities should the need arise. The move reduces our exposure to the bail-in risks outlined above and other risks associated with significant cash holdings.

3.3 We will also continue to monitor interest rates to ensure that we undertake long term borrowing from the PWLB at the most advantageous time to fund our on-going Capital commitments. We are able to borrow at discounted rates from the PWLB to fund our capital programme and we will take advantage of this at the appropriate time.

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 2015/16 agreed by Council in February 2015. The Council has not deviated from the Capital related indicators either.

4.2 Audit Reviews

The Internal Audit review undertaken in February 2015 concluded that good controls within the Treasury management function continue to ensure that it manages its key risks effectively. This is demonstrated by the function's effective management of the recent Housing Revenue Subsidy Account buy-out process. The report listed the following key areas which have been managed well:

- There is regular reporting to elected members on the Council's treasury management activities, and the Corporate Governance Committee approved the annual Treasury Management Strategy Statement and Prudential Indicators in January 2015.

- Investments are only made with permitted institutions detailed in the Treasury Management Strategy Statement, within their specified limits, and a contract with an independent treasury advisory company provides assurance that the investment strategy and decisions are sound.

- Sufficient business continuity arrangements are in place to provide cover within the treasury management function in the absence of the Technical Accountant. A clear separation of duties also exists within the process.

- Since our last review, the Council has borrowed £20m to fund its Corporate Plan. We are satisfied that where loans have been taken out, they are with an agreed lender, an appropriate separation of duty exists within the process and they were authorised by either the former Head of Finance and Assets or the Chief Accountant.

- At the time of our review, the Finance Department had appropriate arrangements in place to effectively manage the upcoming changes to the Housing Revenue Subsidy Account from a treasury management perspective, i.e. whereby the Council will borrow and pay approximately £40m to HM

Treasury to buy itself out of the Housing Revenue Subsidy scheme and become self-financing from April 2015. This is following changes in legislation for how local authorities in Wales manage finances in relation to their housing stocks. *Please note*, following the completion of our testing, we were advised by the Chief Accountant that this transaction has now taken place.

5 Future

5.1 TM Strategy for next six months

As the Corporate Plan is progressing, we will continue to review our cash position to ensure that we undertake 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.

5.2 Reports

The next reports will be the Treasury Management Strategy Statement and Prudential Indicators 2016/17 and the TM Update Report 2015/16 which will be reported to the Corporate Governance Committee in January.