Appendix 2

Treasury Management (TM) Update Report

1 Changes in the external environment

Economic Outlook

1.1 We are continuing to see volatility in financial markets in response to the turbulence in China's financial markets which is a reminder of the emerging economic consequences of globalisation. Investors fear that the scale of the depreciation of China's currency could mean that the slowdown in China's economic growth is even worse than previously thought.

1.2 World growth looks bleaker by the day as the World Bank has downgraded its global forecast for 2016 to 2.9% from 3.3% previously. The Chancellor is warning of a period of global economic uncertainty ahead as a result of a number of factors including a slowdown in China, political instability in the Middle East, concerns over inflationary weakness and the reduction in the price of oil. Indications are that austerity measures will continue to affect Council finances up to 2020.

2 Investment Strategy

2.1 Conventional bank deposits have become riskier because of a lower likelihood that the UK and other governments will 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.

2.2 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority will consider more secure investments such as reverse repurchase agreements (REPOs) and covered bonds as detailed below.

2.3 The Council has also 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.

Reverse Repurchase Agreements (REPOs)

2.4 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.

2.5 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

2.6 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 last 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. We have been accessing temporary borrowing from other local authorities at very low rates to cover short-term cash flow requirements. We are also planning to borrow at discounted rates from the PWLB to fund our 21st century schools capital programme.

3.3 We will continue to undertake temporary borrowing from other local authorities as this is a good source of readily available cash at historically low rates. At the same time, we will also continue to monitor our cash position and interest rate levels to ensure that we undertake long term borrowing from the PWLB at the optimal time to fund our on-going Capital commitments.

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

Following a positive internal audit review in February 2015, the next audit review will be undertaken in February 2016.

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 annual TM Review Report 2015/16 and the TM Update Report 2016/17 which will be reported to the Corporate Governance Committee in September.