Appendix 1

DENBIGHSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT
2015/16

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1. Background

1.1 The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. Reports are made twice a year to the Corporate Governance Committee which is the committee with responsibility for the scrutiny of the Council's treasury policy, strategy and activity, as well as the annual report made to cabinet and the report to full council for approval of the annual treasury strategy.

1.2 Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.3 The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. Economic Background

Growth, Inflation and Employment

2.1 The UK economy slowed in 2015 with GDP growth falling to 2.3% from 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth. CPI picked up to 0.3% in February, but this was still well below the Bank of England's 2% inflation target.

2.2 The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

UK Monetary Policy

2.2 The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its *Inflation Reports* and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

3. Borrowing Activity

3.1 The table below shows the level of the Council's borrowing from the Public Works Loan Board (PWLB) at the start and the end of the year.

	Balance at 01/04/2015 £000	Maturing loans £000	Premature repayments £000	New Borrowing £000	Balance at 31/03/2016 £000
Fixed rate loans – Public Works Loan Board (PWLB)	144,772	3,652	0	49,045	190,165
Total borrowing	**144,772**	**3,652**	**0**	**49,045**	**190,165**

3.2 The Council's strategy in 2015/16 was to internally borrow to fund most of its borrowing requirement but the Council also borrowed at discounted rates from the PWLB to fund its 21st century schools capital programme. In total, two new loans amounting to £9m were undertaken in February and March 2016 at a rate of 1.51% over a 9 year period on an Equal Instalment of Principal (EIP) basis.

3.3 The reform of the HRA subsidy system in Wales was completed at the beginning of 2015/16. The Council borrowed £40m from the PWLB on 02/04/15 to buy itself out of the subsidy scheme to become self-financing.

3.4 The Council also terminated the PFI contract on the county offices in Ruthin on 04/09/15 and as planned, it used a significant proportion of its investment balances to achieve this by buying itself out of the PFI agreement. The Council has been accessing temporary borrowing from other local authorities at very low rates to cover short-term cash flow requirements.

3.5 As a result of maturities and new borrowing during the year, the average rate on the Council's debt decreased from 5.40% at 1 April 2015 to 4.95% at 31 March 2016.

3.6 Annex A shows how interest rates for borrowing have moved over the course of the year.

Abolition of the PWLB

3.7 In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the PWLB. HMT confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. There is a consultation due but HMT hasn't released further details on this matter.

4. Investment Activity

4.1 The Council held cash balances of £12m at the end of 2015/16. These represent the Council's Balances and Reserves, working cash balances and also where money has been borrowed before capital expenditure is incurred.

4.2 The Welsh Government's Investment Guidance requires local authorities to focus on security (keeping the money safe) and liquidity (making sure the Council never runs out of cash) as the primary objectives of a prudent investment policy. The Council's aim was to achieve a return on investments in line with these principles. The return is important but is a secondary consideration and the priority is the security of the sums invested.

4.3 The table below shows the level of the Council's investments at the start and the end of the year.

	Balance at 01/04/2015 £000	Investments Raised £000	Investments Repaid £000	Balance at 31/03/2016 £000
Investments	**28,600**	**341,144**	**357,744**	**12,000**

4.4 The Council's investment income for the year was £0.108m compared to £0.230m in 2014/15 which meant that the low interest rates available in the market continued to have a significant impact on the investment return earned by the Council.

4.5 Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16 which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher if domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

Unsecured Bank Deposits

4.6 Conventional bank deposits became riskier during 2015/16 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.

4.7 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

4.8 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)

4.9 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.

4.10 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

4.11 These are also secured investments with banks which are exempt from bail-in risk and they offer a secure option for long term investments.

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

Credit Risk Management

4.12 Counterparty credit quality was assessed and monitored with reference to the following:

- credit ratings (minimum long-term counterparty rating of A- across rating agencies Fitch / S&P / Moody's);
- analysis of funding structure and susceptibility to bail-in;
- credit default swap prices;
- financial statements;
- information on potential government support;
- share prices.

Liquidity Management

4.13 In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of overnight deposits and instant access call accounts. The Authority uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed.

Yield

4.14 The Council sought to achieve the best return balanced against its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates also remained at very low levels which had a significant impact on investment income.

4.15 All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits. Maturing investments were repaid to the Council in full and in a timely manner.

5. Compliance with Prudential Indicators

5.1 The Council can confirm that it has complied with its Prudential Indicators for 2015/16, which were set in February 2014 as part of the Council's Treasury Management Strategy Statement. Details can be found in Annex B.

5.2 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2015/16. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6. Money Laundering Update

6.1 The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it maintains procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that relevant staff are properly trained.

6.2 The Head of Finance has been appointed as the Money Laundering Reporting Officer. There haven't been any cases of money laundering reported since the start of Denbighshire to date and the risk to the Council is considered to be minimal.

Annex A

Interest Rates 2015/16

Public Works Loan Board (PWLB) borrowing rates and UK Money Market rates during the year were:

Example PWLB Borrowing rates (The rate at which the Council could borrow money from the Government)

Start Date		Length of Loan	
	1yr %	19½-20 yrs %	49½-50 yrs %
01-Apr-15	1.33	3.24	3.31
30-Sep-15	1.44	3.42	3.39
31-Mar-16	1.33	3.21	3.12

Example Bank Rate, Money Market rates (The rate at which the Council could invest with banks)

Date	Bank Rate %	7-day Investment Rates %	1-month Investment Rates %	6-month Investment Rates %
01-Apr-15	0.50	0.46	0.43	0.76
30-Sep-15	0.50	0.41	0.43	0.74
31-Mar-16	0.50	0.44	0.52	0.71

Annex B

Compliance with Prudential Indicators 2015/16

1 Estimated and Actual Capital Expenditure

1.1 This indicator is set to ensure that the level of proposed investment in capital assets remains within sustainable limits and, in particular, to consider the impact on the Council Tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2015/16 Estimated February 2015 £000	2015/16 Revised February 2016 £000	2015/16 Outturn March 2016 £000
Non-HRA	16,254	22,458	20,278
Corporate Plan	30,882	25,198	24,276
HRA	47,059	45,322	44,007
Total	**94,195**	**92,978**	**88,561**

2 Estimated and Actual Ratio of Financing Costs to Net Revenue Stream

2.1 This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Estimated February 2015 £000	2015/16 Revised February 2016 £000	2015/16 Outturn March 2016 £000
Financing Costs	13,268	12,945	12,945
Net Revenue Stream	184,756	180,764	180,764
Non-HRA Ratio	**7.18%**	**7.16%**	**7.16%**
Financing Costs	4,916	5,884	5,890
Net Revenue Stream	13,609	13,183	13,183
HRA Ratio	**36.12%**	**44.63%**	**44.68%**

3 Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is demonstrated in the following table:

Capital Financing Requirement	31/03/2016 Estimated February 2015 £000	31/03/2016 Revised February 2016 £000	31/03/2016 Outturn March 2016 £000
Non-HRA	175,659	176,639	168,546
HRA	69,054	67,037	65,126
Total	**244,713**	**243,676**	**233,672**
Borrowing	**213,194**	**191,165**	**191,165**

NB The outturn figures are taken from the pre-audited Statement of Accounts 2015/16 so they may be subject to change.

Note that the projected debt level at 31/03/16 was originally estimated in February 2015 to be £22m higher than the revised estimate because the original estimate was based on the capital expenditure in the Capital Plan to be funded by borrowing for 2015/16. In practice, the Council internally borrowed during the year to fund part of its borrowing requirement and undertook new external borrowing of £9m to fund the remainder.

4 Authorised Limit and Operational Boundary for External Debt

Summary Table:

2015/16	March 2016 £000
External Borrowing	191,165
Internal Borrowing	42,507
Operational Boundary	245,000
Authorised Limit	250,000

4.1 **Operational Boundary**: This limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity.

4.2 **Authorised Limit**: This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements.

4.3 The levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The Council maintained its total external borrowing and other long-term liabilities within both limits; at its peak this figure was £197.2m. In addition to external borrowing, the Council uses its own reserves and balances to fund capital expenditure and this is known as internal borrowing as shown in the table above.

5 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

5.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a net basis i.e. fixed rate debt net of fixed rate investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on the portfolio of investments.

	2015/16 Estimated %	**2015/16 Actual Peak Exposure %**
Upper Limit for Fixed Rate Exposure	100	100
Upper Limit for Variable Rate Exposure	40	0

6 Maturity Structure of Fixed Rate borrowing

6.1 This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

6.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

Maturity structure of fixed rate borrowing	**Upper limit %**	**Lower limit %**	**Actual Borrowing as at 31/03/2016 £000**	**Percentage of total as at 31/03/2016 %**
under 12 months	30	0	5,439	2.86
12 months and within 24 months	30	0	4,533	2.38
24 months and within 5 years	30	0	12,353	6.50
5 years and within 10 years	30	0	17,486	9.20
10 years and above	100	50	150,354	79.06
Total			**190,165**	**100.00**

7 Total principal sums invested for periods longer than 364 days

7.1 This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. For 2015/16 this limit was set at £10m. The Council did not have any investments which exceeded 364 days during 2015/16 because the policy was to limit investments to a shorter period than 1 year.

8 Adoption of the CIPFA Treasury Management Code

8.1 The Council confirms its adoption of the CIPFA Code of Treasury Management at its Council meeting on 26 March 2002. The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

Annex C

GLOSSARY - Useful guide to Treasury Management Terms and Acronyms

BANK OF ENGLAND	UK's Central Bank
BANK RATE	Bank of England Interest Rate (also known as Base Rate)
CPI	Consumer Price Index – a measure of the increase in prices
RPI	Retail Price Index – a measure of the increase in prices
DMO	Debt Management Office – issuer of gilts on behalf of HM Treasury
FSA	Financial Services Authority - the UK financial watchdog
GDP	Gross Domestic Product – a measure of financial output of the UK
LIBID	London Interbank Bid Rate - International rate that banks lend to other banks
LIBOR	London Interbank Offer Rate – International rate that banks borrow from other banks (the most widely used benchmark or reference for short term interest rates)
PWLB	Public Works Loan Board – a Government department that lends money to Public Sector Organisations
MPC	Monetary Policy Committee - the committee of the Bank of England that sets the Bank Rate
LONG TERM RATES	More than 12 months duration
SHORT TERM RATES	Less than 12 months duration
BOND (GENERAL)	An investment in which an investor loans money to a public or private company that borrows the funds for a defined period of time at a fixed interest rate
GOVERNMENT BOND	A type of bond issued by a national government generally with a promise to pay periodic interest payments and to repay the face value on the maturity date
CORPORATE BOND	A type of bond issued by a corporation to raise money in order to expand its business

COVERED BOND	A corporate bond issued by a financial institution but with an extra layer of protection for investors whereby the investor has recourse to a pool of assets that secures or “covers” the bond if the financial institution becomes insolvent
GILT	A bond that is issued by the British government which is classed as a low risk investment as the capital investment is guaranteed by the government
REPO	A repurchase agreement involving the selling of a security (usually bonds or gilts) with the agreement to buy it back at a higher price at a specific future date For the party selling the security (and agreeing to repurchase it in the future) it is a REPO For the party on the other end of the transaction e.g. the local authority (buying the security and agreeing to sell in the future) it is a reverse REPO
FTSE 100	Financial Times Stock Exchange 100 - An index composed of the 100 largest companies listed on the London Stock Exchange which provides a good indication of the performance of major UK companies