Appendix 2

Treasury Management (TM) Update Report

1 Changes in the external environment

Economic Outlook

1.1 Following the United Kingdom’s vote to leave the European Union, there was initial volatility in UK and European markets. This immediate volatility was far lower than during the credit crunch and ensuing financial crisis, but is expected to continue into the medium term and it is possible that there will be a limited weakening of the UK economy. The long term economic effects remain uncertain, and may be less severe than many previously suggested.

1.2 In view of this volatility, the Council has been taking appropriate steps to reduce its exposure to risk by transferring cash to the UK Government’s Debt Management Office. This approach will continue in the short term while the financial impact of the EU referendum vote is monitored. The Council is receiving regular updates from its treasury advisers and is monitoring the situation closely and is ready to react at short notice if required.

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 long term investments.

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

3 Borrowing Strategy

3.1 The Council has continued with its strategy of internal borrowing to fund most of its borrowing requirement but it has also borrowed at discounted rates from the PWLB to fund the 21st century schools capital programme. In total, two new loans for £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.

3.2 Although the Council hasn't needed any temporary loans since January 2016, it will continue to undertake temporary borrowing from other local authorities if required to cover short-term cash flow requirements in the future as this is a good source of readily available cash at historically low rates. At the same time, the Council will also continue to monitor its cash position and interest rate levels to ensure that long term borrowing is undertaken from the PWLB at the optimal time to fund on-going Capital commitments.

4 Controls

4.1 Prudential Indicators

The Council sets prudential indicators which set boundaries within which its 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 2016/17 agreed by Council in February 2016. The Council has not deviated from the Capital related indicators either.

4.2 **Audit Reviews**

The Internal Audit review undertaken in February 2016 concluded that the treasury management system continues to be well controlled. The report listed the following key areas which have been managed well:

- Internal Audit's testing confirmed that the Council adheres to good practice through adoption of the CIPFA Treasury Management Code, as per the Capital Finance and Accounting Regulations' requirements. It also complies with its own Treasury Management Strategy and Procedures. The Corporate Governance Committee scrutinises and approves the Treasury Management Strategy statement.

- Internal Audit verified that cash flow is monitored and updated regularly, investing surplus cash (when available) and drawing it down when required.

- The Council operates within set conditions on the nature of borrowing and short term investments to minimise exposure to risk or loss.

- The Council obtains and acts on the advice of external Treasury Management Advisors.

- Several officers within Finance are able to carry out treasury management processes to allow continuity of service and appropriate segregation of duties. Access controls within the system are appropriate, including the use of banking software.

5 Future

5.1 **TM Strategy for next six months**

As the Corporate Plan is progressing, the Council will continue to review its cash position to ensure that borrowing is undertaken 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 the TM strategy.

5.2 **Reports**

The next reports will be the Treasury Management Strategy Statement and Prudential Indicators 2017/18 and the TM Update Report 2016/17 which will be reported to the Corporate Governance Committee in January.

6 Wellbeing of Future Generations Act

6.1 From April 2016, the Wellbeing of Future Generations Act comes into force. This puts into law the requirement of public bodies to consider the long-term impact of decisions, alongside current requirements and needs. Financial planning and decision making should ensure that proper regard is given to the requirements of the Act and in particular, proper consideration of the long term impact of financial decisions, including the payback period and whole life costs of capital investment decisions, properly impact assessed budget proposals and long term debt and investment (treasury management) strategies. The principles of prudence, affordability and sustainability are already enshrined within the requirements of the Prudential Code and should underpin financial planning and decision making.

6.2 In the context of treasury management, the existing requirements to assess and report on the long term financial consequences of investment and borrowing decisions using prudential indicators and long-term debt planning support the sustainability goals of the Wellbeing Act.