Appendix 1

DENBIGHSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT
2019/20

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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 Prudential Indicators annually 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 presented 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

2.1 The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

2.2 The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

2.3 GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

2.4 Then coronavirus swiftly changed everything. COVID-19, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

2.5 In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

2.6 The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK.

3. <u>Borrowing Activity</u>

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 01/04/2019 £000	Maturing loans £000	Premature repayments £000	New Borrowing £000	Balance at 31/03/2020 £000
Fixed rate loans – Public Works Loan Board (PWLB)	210,135	7,038	0	25,000	228,097
Total borrowing	**210,135**	**7,038**	**0**	**25,000**	**228,097**

3.2 In line with its TM strategy and following advice from its treasury consultants, the Council has locked in a proportion of its debt at very low rates with the Public Works Loan Board (PWLB) to fund the capital programme. Two new loans for £10m and £15m were undertaken during 2019/20 over a 15 year period on an Equal Instalment of Principal (EIP) basis.

3.3 The Council has also been accessing temporary borrowing from other local authorities at very low rates to cover short-term cash flow requirements.

3.4 As a result of this borrowing, the average rate on the Council's debt decreased from 4.21% at 1 April 2019 to 3.82% at 31 March 2020.

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

4. Investment Activity

4.1 The Council held cash balances of £28.9m at the end of 2019/20. These represent the Council's Balances and Reserves (after internal borrowing and working cash balances are accounted for) 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 01/04/2019 £000	Investments Raised £000	Investments Repaid £000	Balance at 31/03/2020 £000
Investments	**9,700**	**343,300**	**324,100**	**28,900**

4.4 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 2019/20 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

4.5 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.

4.6 Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council has only held a minimal amount of investments for short-term cash flow purposes and has placed a far greater emphasis on investing with the UK Government's Debt Management Office and other local authorities in order to minimise these risks.

Credit Risk Management

4.7 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

4.8 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

4.9 The Council sought to achieve the best return balanced against its objectives of security and liquidity. The UK Bank Rate remained at 0.75% for most of 2019/20 but was cut to 0.1% by the end of the financial year. Short term money market rates also remained at very low levels which had a significant impact on investment income.

4.10 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 2019/20, which were set in February 2019 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 2019/20. 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 has a Money Laundering Policy and maintains procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that relevant staff are properly trained. This policy is due to be reviewed and updated in view of new regulations.

6.2 The Section 151 Officer 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 2019/20

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-19	1.66	2.56	2.44
30-Sep-19	1.48	1.97	1.87
31-Mar-20	2.10	2.81	2.59

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-19	0.75	0.57	0.60	0.83
30-Sep-19	0.75	0.57	0.59	0.70
31-Mar-20	0.10	0.01	0.12	0.60

Annex B

Compliance with Prudential Indicators 2019/20

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	2019/20 Estimated February 2019 £000	2019/20 Revised February 2020 £000	2019/20 Outturn March 2020 £000
Non-HRA	37,934	33,858	28,495
HRA	14,270	12,211	8,500
Total	**52,204**	**46,069**	**36,995**

NB The figures for the February estimate were produced early in January but due to the nature of capital expenditure, some of the major schemes have slipped and this expenditure will now be incurred in 2020/21.

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	2019/20 Estimated February 2019 £000	2019/20 Revised February 2020 £000	2019/20 Outturn March 2020 £000
Financing Costs	11,361	13,652	13,339
Net Revenue Stream	198,538	198,538	198,538
Non-HRA Ratio	**5.72%**	**6.88%**	**6.72%**
Financing Costs	6,992	6,132	5,841
Net Revenue Stream	16,456	16,538	16,538
HRA Ratio	**42.49%**	**37.08%**	**35.32%**

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. Performance during 2019/20 is demonstrated in the following table:

Capital Financing Requirement	2019/20 Estimated February 2019 £000	2019/20 Revised February 2020 £000	2019/20 Outturn March 2020 £000
Non-HRA	216,762	210,283	211,946
HRA	78,508	72,279	70,894
Total	**295,270**	**282,562**	**282,840**
Borrowing	248,763	243,097	256,097

NB The outturn figures are taken from the pre-audited Statement of Accounts 2019/20 so they may be subject to change.

4 Authorised Limit and Operational Boundary for External Debt

Summary Table:

2019/20	31/03/2020 £000
External Borrowing	256,097
Internal Borrowing	26,743
Operational Boundary	265,000
Authorised Limit	270,000

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 £256.1m. 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.

	2019/20 Estimated %	2019/20 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 31/03/2020 £000	Percentage of total as at 31/03/2020 %
under 12 months	30	0	36,090	14.09
12 months and within 24 months	30	0	10,301	4.02
24 months and within 5 years	30	0	22,657	8.85
5 years and within 10 years	30	0	33,391	13.04
10 years and above	100	50	153,658	60.00
Total			**256,097**	**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 2019/20 this limit was set at £10m. The Council did not have any investments which exceeded 364 days during 2019/20 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