Appendix 2

FLINTSHIRE COUNTY COUNCIL

DRAFT TREASURY MANAGEMENT

ANNUAL REPORT 2018/19

1.00 INTRODUCTION

1.01 The Council approved the Treasury Management Strategy (Strategy) 2018/19 including key indicators, limits and an annual investment strategy on 20th February 2018.

1.02 The Strategy was produced based on the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice.

1.03 The purpose of this report is to review the outcomes from 2018/19 treasury management operations and compare these with the Strategy.

1.04 Treasury management comprises the management of the local authority's 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.

2.00 ECONOMIC & INTEREST RATE REVIEW 2018/19

This Provided by Arlingclose Ltd the Council's Treasury Management advisors.

Economic commentary

After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets:

December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

3.00 BORROWING REQUIREMENTS AND DEBT MANAGEMENT

3.01 PWLB (Public Works Loans Board) Certainty Rate

The Council qualified for the PWLB Certainty Rate, allowing the authority to borrow at a reduction of 20 basis points on the Standard Rate for a further 12 months from 1st November 2018.

3.02 Borrowing Activity in 2018/19.

The total long term borrowing outstanding, brought forward into 2018/19 totalled £253.8 million.

	Balance 01/04/2018 £m	Debt Maturing £m	New Debt £m	Balance 31/03/2019 £m
Capital Financing Requirement	**327.6**	(6.1)	18.6	**340.1**
Short Term Borrowing	52.1	(52.1)	44.0	44.0
Long Term Borrowing	253.8	0.0	19.0	272.8
TOTAL BORROWING	305.9	(52.1)	63.0	316.8
Other Long Term Liabilities	5.4	(0.6)	0.2	5.0
TOTAL EXTERNAL DEBT	**311.3**	**(52.7)**	**63.2**	**321.8**
Increase/(Decrease in Borrowing (£m)	-	-	10.5	

3.03 New Long Term Borrowing

The Council's Capital Programme is financed by a combination of capital receipts and grants, CERA (revenue contributions) and borrowing. The borrowing strategy in recent years in accordance with advice received from the Council's Treasury Management advisors, Arlingclose has been to use existing cash balances and short term borrowing to confirm the long term borrowing requirement. This is to ensure that the Council does not commit to long term borrowing too early and borrow unnecessarily which will be costly. This is balanced against securing low interest costs and achieving cost certainty over the period for which the funds are required so as not to compromise the long term stability of the portfolio.

Short term borrowing continued to be available throughout the year at much lower rates than long term borrowing and was utilised as far as possible without exposing the Council to excessive refinancing risk. The total short term (temporary) borrowing as at 31st March 2019 was £44m with an average rate of 0.96%.

The benefit of internal / short term borrowing was monitored closely, in conjunction with Arlingclose, throughout the year against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise modestly.

In December 2018 reductions in PWLB long term rates provided opportunities to secure long term borrowing at low rates and the following loans were taken out on 6th December 2019:

Start Date	Maturity Date	Amount	Rate	Loan Type
6th Dec 2019	6th Dec 2063	£7.53m	2.79%	Annuity
6th Dec 2019	6th Dec 2068	£10.0m	2.64%	Maturity

The £7.53m loan has been on-lent to NEW Homes, the Council's wholly owned subsidiary to fund the building of affordable homes in Flint.

3.04 At 31st March 2019, loans with the Public Works Loans Board were in the form of fixed rate (£238.34m) and variable rate (£10m), £18.95m were variable in the form of LOBO's (Lender's Option, Borrower's Option) and £5.51m were interest free loans from the Government, available for specific schemes. The Council's average rate for long term borrowing was 4.64%.

3.05 The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2019 was £340.1m. The Council's total external debt was £321.8m.

3.06 Loans at Variable Rates

The Council has £10m of PWLB variable rate loans, at an average rate of 0.83% which mitigate the impact of changes in variable rates on the Council's overall treasury portfolio. This strategic exposure to variable interest rates will be regularly reviewed and, if appropriate, reduced by switching into fixed rate loans.

3.07 Lender's Option Borrower's Option Loans (LOBOs)

The Council holds £18.95m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the year, none of which were exercised by the lender.

3.08 Debt Rescheduling

Options for debt rescheduling were explored in conjunction with our treasury management advisors. The premium charged for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

The Corporate Finance Manager, in conjunction with the Council's treasury advisors will continue to review any potential opportunities for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility).

4.00 INVESTMENT ACTIVITY

4.01 The Welsh Government's Investment Guidance gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

4.02 Investment Activity in 2018/19

Summary of investments as at 31st March 2019.

Country	Total	<1 month	1 –12 months	>12 months
	£m	%	£m	£m
UK BANKS				
UK BUILDING SOCIETIES				
OVERSEAS				
MMF's				
LOCAL AUTHORITIES				
DMO	31.2	31.2		
TOTAL	**31.2**	**31.2**	**0.00**	**0.0**

As none of these investments were greater than three months they are classified as cash in the Council's Balance Sheet.

4.03 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 Strategy for 2018/19. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other Local Authorities
- Investments in AAA-rated Constant Net Asset Value Money Market Funds
- Call accounts and deposits with Banks and Building Societies

4.04 Credit Risk

The Authority assessed and monitored counterparty credit quality with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP and share price. The minimum long-term counterparty credit rating determined by the Authority for the 2018/19 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

4.05 Counterparty Update

Credit Background

Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non ring-fenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ring-fenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ring-fenced and non ring-fenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ring-fencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ring-fenced) and investment banking (non ring-fenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

4.06 Liquidity

In keeping with the WG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts.

4.07 Yield

The UK Bank Rate began the year at 0.50% with a rise in August to 0.75% where it has since stayed. Short term money market rates also remained at very low levels which continued to have a significant impact on investment income. The low rates of return on the Authority's short-dated money market investments reflect prevailing market conditions and the Authority's objective of optimising returns commensurate with the principles of security and liquidity.

The Authority's budgeted investment income for the year had been prudently estimated at £40k. The average cash balance was £27.7m during the period and interest earned was £169k, at an average interest rate of 0.58%.

4.08 Loan to NEW Homes

The loan to NEW Homes does not meet the definition of an investment and is not therefore included in the Council's investment figures below. It is classed as capital expenditure.

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5.00 COMPLIANCE

5.01 The Council can confirm that it has complied with its Prudential Indicators for 2018/19. These were approved by Council as part of the Treasury Management Strategy on 20th February 2018.

5.02 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 2018/19. None of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

5.03 The treasury function operated within the limits detailed in the Treasury Management Policy and Strategy Statement 2018/19.

6.00 OTHER ITEMS

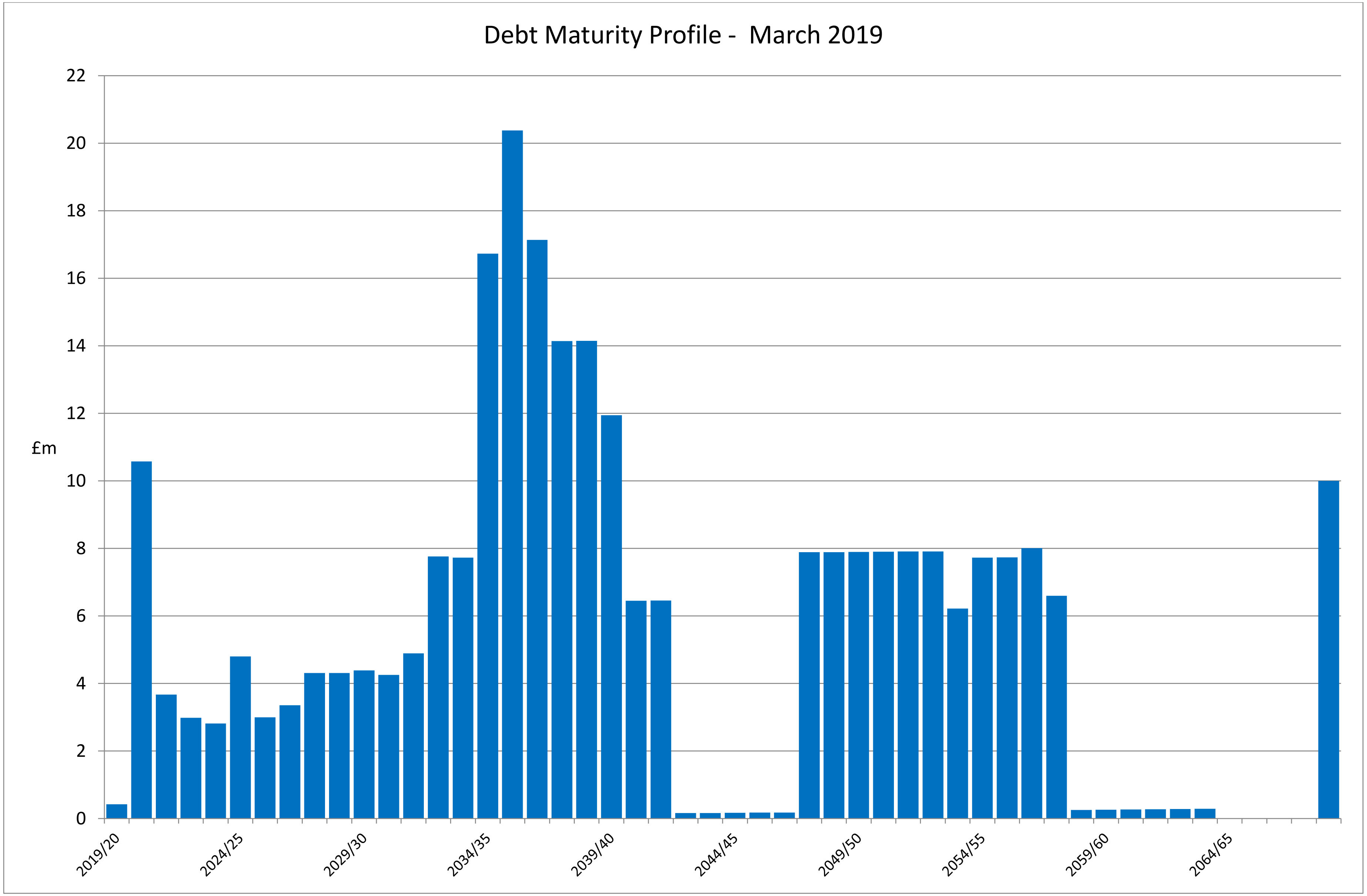
6.01 The following were the main treasury activities during 2018/19

- The Council's Audit Committee received a Mid-Year Report on 21th November 2018.
- Quarterly update reports were presented to the Audit Committee.
- The 2019/20 Investment Strategy Statement was approved by Council on 19th February 2019.
- The Council continues to be member of the CIPFA Treasury Management Network.
- The Council's cash flow was managed on a daily basis. During the year the Council acted both as a borrower and as a lender and was a net borrower over the year in question. The maximum investments the Authority had on deposit at any one time was £54.7m and the maximum long-term borrowing at any one time was £272.8m.

7.00 CONCLUSION

7.01 The treasury management function has operated within the statutory and local limits detailed in the 2018/19 Treasury Management Strategy.

7.02 The Policy was implemented in a pro-active manner with security and liquidity as the focus.



Debt Maturity Profile - March 2019
£m
22
20
18
16
14
12
10
8
6
4
2
0
2019/20
2024/25
2029/30
2034/35
2039/40
2044/45
2049/50
2054/55
2059/60
2064/65