APPENDIX 1

CYNGOR
Sir y Fflint
Flintshire
COUNTY COUNCIL

FLINTSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT

DRAFT ANNUAL REPORT 2019/20

1.00 INTRODUCTION

The Council approved the Treasury Management Strategy 2019/20 (the Strategy) including key indicators, limits and an annual investment strategy on 19th February 2019.

The Strategy was produced based on the 2017 edition of the CIPFA Treasury Management in the Public Services: Code of Practice.

The purpose of this report is to review the outcomes from 2019/20 treasury management operations and compare these with the Strategy.

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 2019/20

This is provided by Arlingclose Ltd, the Council’s treasury management advisors.

2.01 Economic commentary

The UK’s exit from the European Union and future trading arrangements had remained one of the 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.

The headline rate of UK Consumer Price Inflation fell to 1.7% year on year 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.

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%.

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.

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.

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.

The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

2.02 Financial markets

Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touched its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

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 2019.

3.02 Borrowing Activity in 2019/20.

The total long term borrowing outstanding, brought forward into 2019/20 totalled £272.8 million.

	Balance 01/04/2019 £m	Debt Maturing £m	New Debt £m	Balance 31/03/2020 £m
Capital Financing Requirement	**340.1**	(6.6)	16.8	**350.3**
Short Term Borrowing	44.0	(44.0)	53.0	53.0
Long Term Borrowing	272.8	(0.9)	19.4	291.3
TOTAL BORROWING	**316.8**	**(44.9)**	**72.4**	**344.3**
Other Long Term Liabilities	5.0	(0.5)	0.0	4.5
TOTAL EXTERNAL DEBT	**321.8**	**(45.4)**	**72.4**	**348.8**
Increase/(Decrease in Borrowing (£m)	-	-	27.0	

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 2020 was £53m with an average rate of 1.07%.

The relative costs and benefits of internal / short term borrowing and long term borrowing were monitored closely, in conjunction with Arlingclose, throughout the year. The Council continues to have a long term borrowing requirement and as PWLB long term rates remained low during the year the following loans were taken out:

Start Date	Maturity Date	Amount	Rate	Loan Type
1st Apr 2019	1st Apr 2034	£10.0m	1.65%	EIP
13th Aug 2019	13th Aug 2037	£7.5m	1.28%	EIP
7th Jan 2020	7th Jan 2060	£584k	3.06%	Annuity
30th Mar 2020	30th Mar 2060	£294k	2.65%	Annuity
30th Mar 2020	30th Mar 2060	£1.07m	2.65%	Annuity

£1.95m of these loans have been on-lent to NEW Homes, the Council's wholly owned subsidiary, to fund the building of affordable homes in Flintshire.

At 31st March 2020, loans with the PWLB were in the form of fixed rate (£257.16m) and variable rate (£10m), £18.95m were variable in the form of LOBO's (Lender Option Borrower Option) and £5.17m were interest free loans from the Government, available for specific schemes. The Council's average rate for long term borrowing was 4.57%.

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31st March 2020 was £350.3m. The Council's total external debt was £348.8m.

3.03 Loans at Variable Rates

The Council has £10m of PWLB variable rate loans, at an average rate of 0.91% 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.

3.04 Lender Option Borrower Option loans (LOBOs)

The Council holds £18.95m of LOBOs, 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.

3.05 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. As a consequence no rescheduling activity was undertaken.

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 Guidance

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 2019/20

Summary of investments as at 31st March 2020.

Country	Total	<1 month	1 –12 months	>12 months
	£m	%	£m	£m
UK BANKS				
UK BUILDING SOCIETIES				
OVERSEAS				
MMF's				
LOCAL AUTHORITIES				
DMO	31.1	31.1		
TOTAL	**31.1**	**31.1**	**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.

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 2019/20. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other local authorities
- Investments in AAA-rated Low Volatility Net Asset Value (LVNAV) money market funds
- Call accounts and deposits with banks and building societies

4.03 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 2019/20 treasury strategy was A-/A-/A3 across rating agencies Fitch, S&P and Moody's.

4.04 Counterparty Update

In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ring-fenced) remains the highest at 128bps and National Westminster Bank Plc (ring-fenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

While the UK and non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

4.05 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.

4.06 Yield

The UK Bank Rate began the year at 0.75% with decreases in March to 0.25% then to 0.10%. 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 £80k. The average cash balance was £25.9m during the period and interest earned was £163k, at an average interest rate of 0.62%.

4.07 Loans to NEW Homes

The loans to NEW Homes do not meet the definition of an investment and are not therefore included in the Council's investment figures below. They are classed as capital expenditure.

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5.00 <u>COMPLIANCE</u>

The Council can confirm that it has complied with its Prudential Indicators for 2019/20. These were approved by Council as part of the Treasury Management Strategy on 19th February 2019.

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 taking in relation to investment activity with priority being given to security and liquidity over yield.

The treasury function operated within the limits detailed in the Treasury Management Policy and Strategy Statement 2019/20.

6.00 OTHER ITEMS

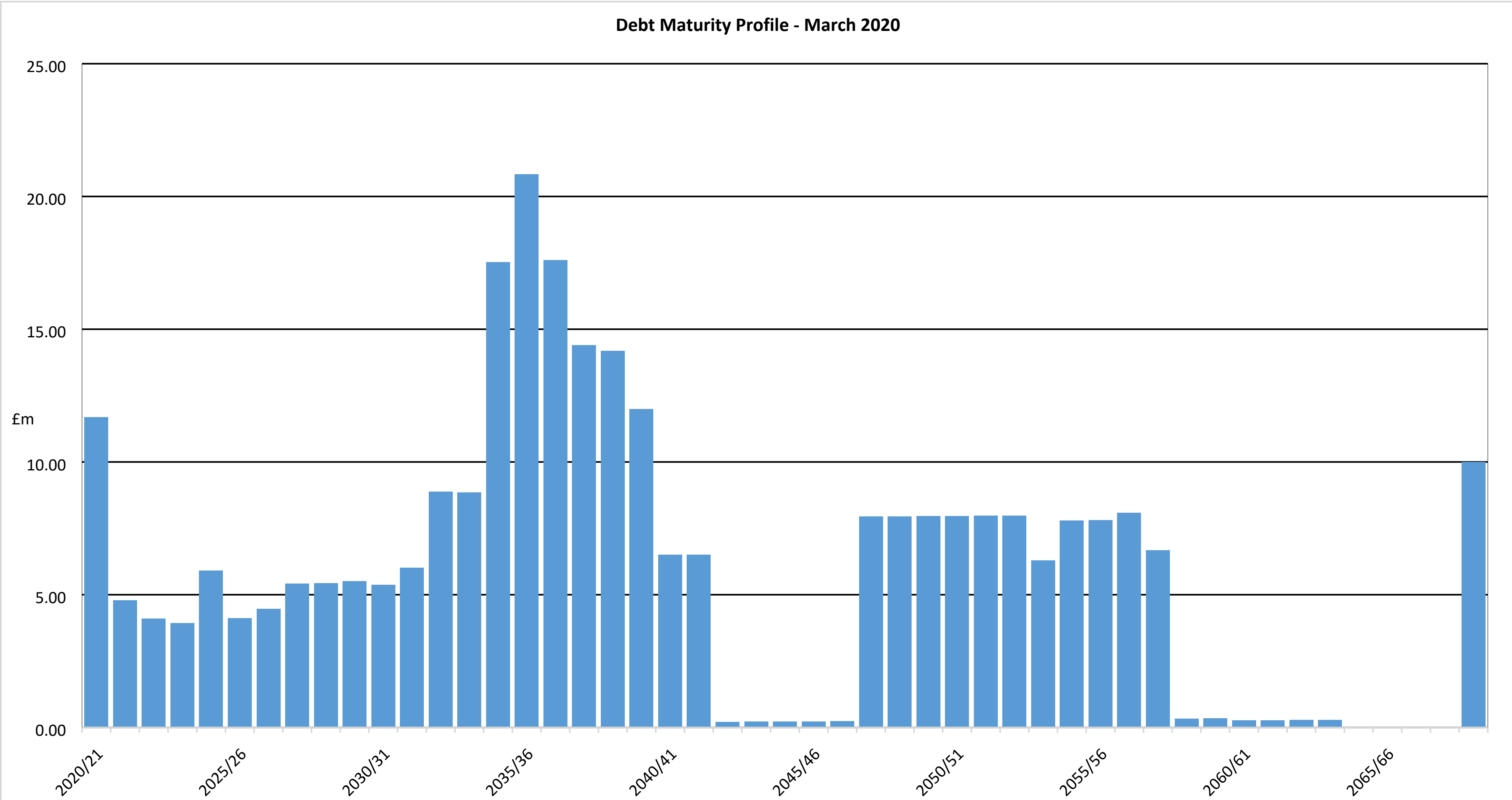
The following were the main treasury activities during 2019/20

- The Council's Audit Committee received a Mid-Year Report on 20th November 2019.
- Quarterly update reports were presented to the Audit Committee.
- The 2020/21 Investment Strategy Statement was approved by Council on 18th February 2020.
- The Council continued to be a 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 were £50.5m and the maximum long-term borrowing at any one time was £291.3m.

7.00 CONCLUSION

The treasury management function has operated within the statutory and local limits detailed in the 2019/20 Treasury Management Strategy.

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


Debt Maturity Profile - March 2020
£m
25.00
20.00
15.00
10.00
5.00
0.00
2020/21
2025/26
2030/31
2035/36
2040/41
2045/46
2050/51
2055/56
2060/61
2065/66