Appendix 1

DENBIGHSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT 2013/14

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1. Background

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.

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."

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. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

2. Economic Background

At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy and the threat of a 'triple-dip' alongside falling real wages (i.e. after inflation) were a concern for the Bank of England's Monetary Policy Committee.

With new Governor Mark Carney at the helm, the Bank of England unveiled forward guidance in August pledging to not consider raising interest rates until the unemployment rate fell below the 7% threshold. In the Bank's initial forecast, this level was only expected to be reached in 2016. Although the Bank stressed that this level was a ***threshold*** for consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.

The recovery in the UK surprised with strong economic activity and growth. Q4 2014 GDP showed year-on-year growth of 2.7%. Much of the improvement was down to the dominant service sector, and an increase in household consumption buoyed by the pick-up in housing transactions which were driven by higher consumer confidence, greater availability of credit and strengthening house prices which were partly boosted by government initiatives such as Help-to-Buy. However, business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth. Worries of a housing bubble were tempered by evidence that net mortgage lending was up by only around 1% annually.

3. Borrowing Activity

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

	Balance at 01/04/2013 £000	Maturing loans £000	Premature repayments £000	New Borrowing £000	Balance at 31/03/2014 £000
Fixed rate loans – Public Works Loan Board (PWLB)	133,269	1,621	0	10,000	141,648
Total borrowing	**133,269**	**1,621**	**0**	**10,000**	**141,648**

The Council's strategy in 2013/14 was to internally borrow to fund part of its borrowing requirement and to undertake new external borrowing to fund the remainder. Two new loans for £10m were undertaken at the start of 2014 to take advantage of relatively low rates before the anticipated increase in rates. The first loan was for £5m in February at a rate of 3.5% over a 17.5 year period on an Equal Instalment of Principal (EIP) basis. The second loan was for £5m in March at a rate of 3.38% over a 17.5 year period on an EIP basis.

The use of internal resources to fund the borrowing requirement was sustainable during 2013/14 because the Council had sufficient reserves and balances to avoid the need for external borrowing. We took the view however that the Corporate Plan is progressing so our reserves will reduce and we will come to a point where we need to borrow in the future. We reviewed our strategy and decided to borrow to take advantage of the low rates at that time. The EIP basis means that we will pay off an equal amount of principal each year so it will not have an adverse impact on our maturity profile. The borrowing we undertook was also affordable as we have a capital financing budget to fund the cost of the borrowing.

Although this will create a cost of carry while the proceeds are temporarily held as investments, we will save in the long term because of the anticipated increase in borrowing rates which will result in higher interest costs. For example, a 1% increase in the rates would cost us approximately £900k more in interest based on the example above of a £10m loan over a 17.5 year period.

As a result of maturities and new borrowing during the year, the average rate on the Council's debt decreased from 5.77% at 1 April 2013 to 5.63% at 31 March 2014.

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

4. Investment Activity

The Council held average cash balances of £30.8m during the year. These represent the Council's Balances and Reserves, working cash balances and also where money has been borrowed before capital expenditure is incurred.

The Welsh Government's Investment Guidance requires local authorities to focus on security (keeping the money safe) and liquidity (making sure we never run 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.

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

	Balance at 01/04/2013 £000	Investments Raised £000	Investments Repaid £000	Balance at 31/03/2014 £000
Investments	**11,000**	**242,550**	**221,050**	**32,500**

The Council's investment income for the year was £0.265m compared to £0.239m in 2012/13 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.

Security of capital remained the Authority's main investment objective. This was maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14 which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

Investments with banks and building societies were held in call accounts and fixed-rate term deposits. The maximum duration of these investments was 12 months in line with the prevailing credit outlook during the year as well as market conditions.

Credit Risk Management:

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);
- credit default swaps;
- GDP of the country in which the institution operates;
- the country's net debt as a percentage of GDP;
- any potential support mechanisms;
- share price.

In July Moody's placed the A3 long-term ratings of Royal Bank of Scotland and NatWest Bank and the D+ standalone financial strength rating of RBS on review for downgrade amid concerns about the impact of any potential breakup of the bank on creditors. As a precautionary measure the Authority reduced its duration to overnight for new investments with the bank(s). In March Moody's downgraded the long-term ratings of both banks to Baa1. As this rating is below the Authority's minimum credit criterion of A-, RBS was withdrawn from the counterparty list for further investment. Natwest is the Council's banker and will continue to be used for operational and liquidity purposes.

Liquidity Management:

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:

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.

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

The Council can confirm that it has complied with its Prudential Indicators for 2013/14, which were set in February 2013 as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix B.

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 2013/14. 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

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.

The Head of Finance and Assets 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 we consider the risk to the Council to be minimal.

Appendix A

Interest Rates 2013/14

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
02-Apr-13	1.11	3.87	4.22
30-Sep-13	1.30	4.36	4.48
31-Mar-14	1.46	4.43	4.49

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-13	0.50	0.50	0.40	0.51
30-Sep-13	0.50	0.38	0.41	0.51
31-Mar-14	0.50	0.39	0.42	0.56

Appendix B

Compliance with Prudential Indicators 2013/14

1 Estimated and Actual Capital Expenditure

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	2013/14 Estimated February 2013 £000	2013/14 Revised February 2014 £000	2013/14 Outturn March 2014 £000
Non-HRA	29,727	30,559	30,228
Corporate Plan	6,603	7,139	5,250
HRA	9,182	7,384	6,525
Total	**45,512**	**45,082**	**42,003**

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

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	2013/14 Estimated February 2013 £000	2013/14 Revised February 2014 £000	2013/14 Outturn March 2014 £000
Financing Costs	12,168	12,669	12,530
Net Revenue Stream	190,687	191,573	191,573
Non-HRA Ratio	**6.38%**	**6.61%**	**6.54%**
Financing Costs	3,092	2,973	2,914
Net Revenue Stream	12,662	12,727	12,727
HRA Ratio	**24.42%**	**23.36%**	**22.90%**

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 - Non-PFI Basis	31/03/2014 Estimated February 2013 £000	31/03/2014 Revised February 2014 £000	31/03/2014 Outturn March 2014 £000
Non-HRA	150,707	145,486	145,801
HRA	33,375	30,669	29,508
Total	**184,082**	**176,155**	**175,309**
Borrowing	**153,460**	**141,648**	**141,648**
PFI Liability	10,526	10,526	10,526

NB The outturn figures are taken from the pre-audited Statement of Accounts 2013/14 so they may be subject to change.

Note that the projected debt level at 31/03/14 was originally estimated in February 2013 to be £12m 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 2013/14. In practice, the Council internally borrowed during the year to fund part of its borrowing requirement and undertook new external borrowing of £10m to fund the remainder.

4 Authorised Limit and Operational Boundary for External Debt

Summary Table:

2013/14	February 2014 £000
External Borrowing	141,648
Internal Borrowing	33,661
Operational Boundary	160,000
Authorised Limit	165,000

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 and was set originally at £170m in February 2013 and revised downwards to £160m in February 2014 for the reasons outlined above.

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. This limit was set originally at £175m in February 2013 and revised downwards to £165m in February 2014 for the reasons outlined above.

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 £141.7m. 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 our portfolio of investments.

	2013/14 Estimated %	**2013/14 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 31/03/2014 £000**	**Percentage of total as at 31/03/2014 %**
under 12 months	5	0	6,662	4.70
12 months and within 24 months	5	0	3,227	2.28
24 months and within 5 years	20	0	10,087	7.12
5 years and within 10 years	25	0	12,702	8.97
10 years and above	100	50	108,970	76.93
Total			**141,648**	**100**

7 Total principal sums invested for periods longer than 364 days

This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. For 2013/14 this limit was set at £6m. The Council did not have any investments which exceeded 364 days during 2012/13 because the policy was to limit investments to a shorter period than 1 year.

8 Adoption of the CIPFA Treasury Management Code

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.