Appendix 2

DENBIGHSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT
2011/12

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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 Audit 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."

Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

2. Economic Background

At the time of determining the 2011/12 strategy in Feb 2011, there were tentative signs that the UK was emerging from recession with the worst of the financial crisis behind it. Recovery in growth was expected to be slow and uneven as the austerity measures announced in the 2010 Comprehensive Spending Review were implemented in order to bring down the budget deficit and government borrowing and rebalance the economy and public sector finances. Inflation measured by the Consumer Price Index (CPI) had remained stubbornly above 3%. Unemployment was at a 16-year high at 2.5 million and was expected to rise further as the public and private sector contracted. There was also a high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

It was not surprising that the Bank of England's Monetary Policy Committee maintained the status quo on the Bank Rate which has now been held at 0.5% since March 2009, but increased asset purchases by £75bn in October 2011 and another £50bn in February 2012 taking the Quantitative Easing (QE) total to £325bn.

The policy measures announced in the March 2012 Budget statement were judged to be neutral. The government stuck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets; the OBR identified oil price shocks and a further deterioration in Europe as the main risks to the outlook for growth and in meeting the fiscal target.

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 01/4/2011 £000	Maturing loans £000	Premature repayments £000	New Borrowing £000	Balance at 31/3/2012 £000
Fixed rate loans – Public Works Loan Board (PWLB)	131,280	1,390	0	5,000	134,890
Temporary Borrowing	0	10,500	0	10,500	0
Total borrowing	**131,280**	**11,890**	**0**	**15,500**	**134,890**

The strategy in 2011/12 was mainly to use internal resources instead of external borrowing as the most cost effective means of funding capital expenditure. The only exception to this was in August when the Council took advantage of low borrowing rates by taking out a new 10 year loan of £5m at 2.46%.

Whenever cash was required for short term cash flow purposes, the Council also undertook temporary loans through the market which was readily available at very low rates of approximately 0.3%.

As a result of new borrowing and maturities during the year, the average rate on the Council's debt decreased from 5.84% at 1 April 2011 to 5.74% at 31 March 2012 which will result in an annual saving of approximately £135k based on the level of borrowing at the end of 2011/12.

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 £27m 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 01/4/2011 £000	Investments Raised £000	Investments Repaid £000	Balance at 31/3/2012 £000
Investments	**22,000**	**194,900**	**195,900**	**21,000**

The Council's investment income for the year was £0.408m compared to £0.398m in 10/11 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 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 2011/12. Investments during the year included:

- Deposits with the Debt Management Office
- Deposits with other Local Authorities
- Call accounts and deposits with Banks and Building Societies

Credit risk:

Counterparty credit quality was assessed and monitored with reference to the following:

- credit ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's);
- 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.

Downgrades in the autumn of 2011 to the long-term ratings of several counterparties resulted in their ratings falling below the Council's minimum threshold of A+. The downgrades were driven principally by the agencies' view of the extent of future government support rather than a deterioration in the institutions' creditworthiness. Further use of these counterparties was suspended until revised criteria were approved for use from 1st April 2012.

One of the banks affected was the Council's own bank, Natwest, so it was recommended in a report to Council that an exception was made in this case for operational purposes to allow the Council to place up to £4m in the Natwest instant access account and this was agreed.

Liquidity:

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.

Yield:

The Council sought to achieve the best return balanced against its objectives of security (credit risk management) and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which had a significant impact on investment income. The Council also had a level of core cash which was not required in the short-term and this was invested for periods of up to 12 months to achieve a higher rate of return.

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 2011/12, which were set in February 2011 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 2011/12. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Appendix A

Interest Rates 2011/12

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-11	1.93	5.33	5.28
30-Sep-11	1.51	4.35	4.69
31-Mar-12	1.28	4.17	4.36

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-11	0.50	0.54	0.54	1.12
30-Sep-11	0.50	0.60	0.54	1.21
31-Mar-12	0.50	0.55	0.61	1.33

Appendix B

Compliance with Prudential Indicators 2011/12

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	**2011/12 Estimated Feb 11 £000**	**2011/12 Revised Feb 12 £000**	**2011/12 Outturn Mar 12 £000**
Non-HRA	40,827	30,708	34,047
HRA	5,969	5,413	5,686
Total	**46,796**	**36,121**	**39,733**

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	**2011/12 Estimated Feb 11 £000**	**2011/12 Revised Feb 12 £000**	**2011/12 Outturn Mar 12 £000**
Financing Costs	11,663	11,585	12,104
Net Revenue Stream	174,985	175,145	175,145
Non-HRA Ratio	**6.67%**	**6.61%**	**6.91%**
Financing Costs	2,859	2,586	2,585
Net Revenue Stream	11,757	11,295	11,295
HRA Ratio	**24.32%**	**22.90%**	**22.89%**

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	31/3/12 Estimated Feb 11 £000	31/3/12 Revised Feb 12 £000	31/3/12 Outturn Mar 12 £000	31/3/13 Estimated Feb 12 £000	31/3/14 Estimated Feb 12 £000
Non-HRA	147,048	137,346	137,577	151,245	147,285
HRA	26,947	25,607	25,852	28,696	28,619
Total	**173,995**	**162,953**	**163,429**	**179,941**	**175,904**
Borrowing	**151,353**	**134,890**	**134,890**	**158,197**	**161,258**
PFI Liability	11,302	10,993	11,136	10,676	10,564

NB The outturn figures are taken from the pre-audited Statement of Accounts 2011/12 so they may be subject to change.

4 Authorised Limit and Operational Boundary for External Debt

Summary Table:

2011/12	£000
External Borrowing	**134,890**
Internal Borrowing	**29,298**
Operational Boundary	**170,000**
Authorised Limit	**175,000**

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 at £170m for the financial year.

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 at £175m for 2011/12.

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 £139.7m. 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 Incremental Impact of Capital Investment Decisions

5.1 This is an indicator of affordability that shows the impact of approved capital investment decisions on Council Tax and Housing Rent levels when the budget for the year was set.

Incremental Impact of Capital Investment Decisions	2011/12 £
Increase in annual Band D Council tax	22.73
Increase in average weekly housing rents	1.76

There is no variation to council tax once it has been set prior to the commencement of the financial year.

6 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

6.1 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.

	2011/12 Estimated %	2011/12 Actual Peak Exposure %
Upper Limit for Fixed Rate Exposure	100	100
Upper Limit for Variable Rate Exposure	40	0

7 Maturity Structure of Fixed Rate borrowing

7.1 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.

7.2 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 31/3/2012 £000	Percentage of total as at 31/3/2012 %
under 12 months	5	0	1,621	1.20
12 months and within 24 months	5	0	1,621	1.20
24 months and within 5 years	10	0	12,189	9.04
5 years and within 10 years	25	0	12,702	9.42
10 years and above	100	50	106,757	79.14
Total			**134,890**	**100**

8 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 2011/12 this limit was set at £6m. The Council did not have any investments which exceeded 364 days during 2011/12 because the policy was to limit investments to a shorter period than 1 year.

9 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.