Appendix 1

Treasury Management Update Report

1 Changes in the external environment

1.1 Economic Outlook

Financial markets are volatile at the moment. The stresses are most extreme in Europe where the lack of real progress in resolving the sovereign debt problem is affecting even the stronger countries. The debt problems have been well publicised with the situation in Greece being the most difficult but with significant risks also facing the Portuguese, Italian and Spanish economies.

With the current instability in the Eurozone and the potential for contagion if a significant bank were to fail or a country were to default, the Council is being very cautious in relation to our current investment strategy and this is likely to continue for the medium term.

2 Investments

2.1 Following the ongoing economic turmoil in the Eurozone, the Head of Finance & Assets decided earlier in the year to limit the Council's exposure to 7 days for all new investments with the UK banks which it invests with as listed below. The decision was made because of concerns about the exposure of UK banks to European countries.

Barclays Bank
Nationwide BS
Royal Bank of Scotland Plc / NatWest Bank Plc
Lloyds TSB Bank Plc / Bank of Scotland Plc

2.2 In practice, this means that all of the Council's cash is now invested in instant access accounts. The total currently stands at £20m and is earning interest at an average rate of 0.75%.

2.3 The Council is also able to invest with the UK Government's Debt Management Office which is currently paying a rate of 0.25%. We have also opened a safe custody account which enables us to purchase Treasury Bills from the Government and these pay a similar rate of return. These options are used as a last resort if safe limits have been reached with financial institutions.

2.4 In view of the limited number of banks which are available now for new investments, the Council intends to reduce its investment balances and to use temporary borrowing as a means of funding short term cash flow requirements.

3 Treasury Management Strategy Statement

Background

3.1 We are required to produce a Treasury Management Strategy Statement each year which must be approved by full Council in February. The Corporate Governance Committee will be required to review the Strategy Statement in January prior to approval by Council.

Investment Strategy

3.2 The Statement outlines what the Council's treasury position is and what the investment strategy will be for the forthcoming financial year. The strategy lists the types of investments that can be used by the Council and sets limits for each type. The countries and institutions that we are permitted to use are also listed along with an explanation of the rationale for selecting particular countries and financial institutions. The council's treasury strategy puts the safety of investments ahead of yield though prudent options are always considered if appropriate.

Borrowing Strategy

3.3 The Statement also outlines the borrowing strategy for the forthcoming year and lists the various sources of borrowing which we are permitted to use. The strategy will outline how the current policy is likely to continue in the medium term. This means that we will continue to reduce our investment balances and rely on internal borrowing as much as possible instead of external borrowing. This is sustainable while the Council has sufficient balances and reserves to avoid the need for external borrowing but this will be monitored throughout the year with a view to externalising borrowing if required.

4 Prudential Indicators

4.1 In addition to treasury limits, the Strategy Statement sets prudential indicators which set boundaries within which our treasury management activity operates. The indicators are calculated to demonstrate that the Council's borrowing is affordable and include measures that show the impact of capital and borrowing decisions over the medium term. The Council has remained within all of its borrowing and investment limits for 2012/13 agreed by Council in February 2012. The Council has not deviated from the Capital related indicators either.

4.2 There are twelve indicators of which five are capital related and seven are treasury related.

Capital Indicators

4.3 The Capital related indicators provide estimates of the capital expenditure over a three year period and are set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

4.4 Estimates of the Capital Financing Requirement (CFR) are also provided over a three year period and this is a measure of the Council's underlying need to borrow. The Capital Plan relies on various sources of finance i.e. grants, contributions and capital receipts. Once these are used up, we need to rely on borrowing and the CFR is the amount we need to borrow. The indicators are set to ensure that our borrowing doesn't exceed the CFR by comparing our CFR and borrowing levels for the current and future years.

4.5 As each council's capital requirements and funding strategies are different, prudential indicators are designed to show the impact of these relative to the overall position of the Council. They are not necessarily useful as a measure between councils.

.

Treasury Management Indicators

4.6 We are required to set borrowing limits which set the maximum level of our external borrowing over a three year period. These are set with reference to the Council's estimates of the CFR and the limits are based on the Council's existing capital commitments and future proposals for capital expenditure.

4.7 The indicators also set upper limits on our exposure to fixed and variable interest rates to manage the extent to which we are exposed to changes in interest rates. These limits give us the flexibility to undertake new loans on a fixed or variable rate basis which will be influenced by expectations of anticipated interest rate movements.

4.8 We also set limits on the amount of debt maturing within various time periods to avoid large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

4.9 The final indicator sets an upper limit for sums invested over 364 days to limit our exposure to long term investments. In practice, we are not investing beyond 7 days in the current climate so this is not applicable at the moment.

5 Money Laundering

5.1 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 maintains procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that relevant staff are properly trained.

5.2 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.

6 Future

6.1 TM Strategy for next six months

As stated above, the Council intends to reduce its investment balances and to use temporary borrowing as a means of funding short term cash flow requirements.

6.2 Reports

The next report will be the Treasury Management Strategy Statement and Prudential Indicators 2013/14 which will be reported to the Corporate Governance Committee in January and to Council in February.

ADDENDUM

1 Updated Investment Advice

1.1 The Council's treasury advisers, Arlingclose Ltd, have been monitoring economic and political developments in the UK, Europe and globally and they are now comfortable with extending the duration limits with the banks which we use. As reported in the TM Update Report, the Council's current policy is to limit all investments to 7 days but the latest advice was received after the report had been submitted so this has been added as an addendum. We have considered the advice received from our advisers and we intend to relax our criteria and extend the current self imposed 7 day time limit to reflect the limits shown below.

1.2 The latest advice received from our advisers is to increase our duration limits with the following UK banks which are currently used by the Council:

- Royal Bank of Scotland (RBS), National Westminster, Lloyds TSB and Bank of Scotland for a maximum period of **6 months**;

- Nationwide BS and Barclays for a maximum period of **12 months**.

1.3 We wouldn't gain by using the first option listed above because we are earning 0.8% with RBS/National Westminster and 0.75% with Lloyds TSB/Bank of Scotland in instant access call accounts. We would need to invest for 9 months with RBS to earn 0.8% so there is no gain to be had by taking advantage of the option to extend the duration limit in this case.

1.4 We would benefit if we took advantage of the second option listed above because we are only earning 0.5% with Barclays in our instant access call account but we could earn 1.07% if we invested for 12 months.

1.5 Extending the duration limits will not therefore yield substantial gains and the instant access call accounts give greater flexibility to reduce our investment cash without the need for borrowing. We will however extend the investment term where it makes financial sense to do so.