Appendix 1

DENBIGHSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT
2012/13

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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."

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

The global outlook stabilised mainly due to central banks maintaining low interest rates for an extended period. The economy shrank in the first, second and fourth quarters of the calendar year 2012. It was the impressive 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012. The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy.

Household financial conditions and purchasing power were constrained as wage growth remained subdued at 1.2% and was outstripped by inflation. Annual CPI dipped below 3%, falling to 2.4% in June before ticking up to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.

The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases (QE) in July, taking total QE to £375 billion. The possibility of a rate cut was discussed at some of the Bank's Monetary Policy Committee meetings, but was not implemented as the potential drawbacks outweighed the benefits of a reduction in the Bank Rate.

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 01/04/2012 £000	Maturing loans £000	Premature repayments £000	New Borrowing £000	Balance at 31/03/2013 £000
Fixed rate loans – Public Works Loan Board (PWLB)	134,890	1,621	0	0	133,269
Total borrowing	**134,890**	**1,621**	**0**	**0**	**133,269**

The strategy in 2012/13 was to use internal resources instead of external borrowing as the most cost effective means of funding capital expenditure. This was sustainable during 2012/13 because the Council had sufficient reserves and balances to avoid the need for external borrowing.

As a result of maturities during the year, the average rate on the Council's debt increased from 5.74% at 1 April 2012 to 5.77% at 31 March 2013.

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 £26m 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 01/04/2012 £000	Investments Raised £000	Investments Repaid £000	Balance at 31/03/2013 £000
Investments	**21,000**	**192,000**	**202,000**	**11,000**

The Council's investment income for the year was £0.239m compared to £0.408m in 2011/12 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 2012/13. Investments during the year included:

- Deposits with the Debt Management Office
- 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 (minimum long-term counterparty rating of A- / A- / A3 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 June Moody's downgraded a swathe of banks with global capital market operations, including the UK banks on the Council's lending list (Barclays, HSBC, Royal Bank of Scotland/Natwest, Lloyds TSB Bank/Bank of Scotland, Santander UK plc) as well as several non UK banks, but none of the ratings fell below the Council's minimum A- / A3 credit rating threshold.

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 and liquidity. The UK Bank Rate was maintained at 0.5% through the year.

The Council considered an appropriate risk management response to uncertain and deteriorating credit conditions in Europe was to shorten maturities for new investments. 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 2012/13, which were set in February 2012 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 2012/13. 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 2012/13

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-12	1.29	4.22	4.41
28-Sep-12	1.15	3.71	4.14
28-Mar-13	1.13	3.87	4.22

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-12	0.50	0.55	0.61	1.33
30-Sep-12	0.50	0.52	0.40	0.66
31-Mar-13	0.50	0.40	0.40	0.51

Appendix B

Compliance with Prudential Indicators 2012/13

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	2012/13 Estimated February 2012 £000	2012/13 Revised February 2013 £000	2012/13 Outturn March 2013 £000
Non-HRA	34,779	32,813	31,883
HRA	7,452	7,452	6,462
Total	**42,231**	**40,265**	**38,345**

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	2012/13 Estimated February 2012 £000	2012/13 Revised February 2013 £000	2012/13 Outturn March 2013 £000
Financing Costs	12,257	12,285	12,656
Net Revenue Stream	177,379	188,795	188,795
Non-HRA Ratio	**6.91%**	**6.51%**	**6.70%**
Financing Costs	2,649	2,666	2,700
Net Revenue Stream	11,874	11,865	11,865
HRA Ratio	**22.31%**	**22.47%**	**22.76%**

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	31/03/2013 Estimated February 2012 £000	31/03/2013 Revised February 2013 £000	31/03/2013 Outturn March 2013 £000
Non-HRA	151,245	141,732	140,660
HRA	28,696	29,212	28,165
Total	**179,941**	**170,944**	**168,825**
Borrowing	**158,197**	**133,269**	**133,269**
PFI Liability	10,676	10,638	10,638

NB The outturn figures are taken from the pre-audited Statement of Accounts 2012/13 so they may be subject to change.

Note that the projected debt level at 31/03/13 was originally estimated in February 2012 to be £25m 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 2012/13. In practice, the Council internally borrowed during the year as discussed earlier in the report and did not undertake any external borrowing in 2012/13.

4 Authorised Limit and Operational Boundary for External Debt

Summary Table:

2012/13	February 2013 £000
External Borrowing	133,269
Internal Borrowing	35,556
Operational Boundary	150,000
Authorised Limit	155,000

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 £175m in February 2012 and revised downwards to £150m in February 2013 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 £180m in February 2012 and revised downwards to £155m in February 2013 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 £134.9m. 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.

	2012/13 Estimated %	**2012/13 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 31/03/2013 £000**	**Percentage of total as at 31/03/2013 %**
under 12 months	5	0	1,621	1.22
12 months and within 24 months	5	0	6,091	4.57
24 months and within 5 years	20	0	8,634	6.47
5 years and within 10 years	25	0	11,232	8.43
10 years and above	100	50	105,691	79.31
Total			**133,269**	**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 2012/13 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.