Item 7

North York Moors National Park Authority
Finance, Risk, Audit and Standards Committee

3 February 2014

Treasury Management and The Prudential Code for Capital Finance
Report of the Treasurer

1. Purpose of the Report

To consider the updated Annual Treasury Management Strategy and Annual Investment Strategy for 2014/15, and Prudential Indicators for the financial years 2014/15 – 2016/17, prior to submission to Authority for approval on 24 March 2014.

2. Background

2.1 Treasury Management is defined as

"the Management of the Authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with these activities and the pursuit of optimum performance consistent with those risks."

2.2 Members will be aware that each February this Committee considers reports on Treasury Management and the Prudential Code Indicators for borrowing. The function of Treasury Management is undertaken for the Authority by North Yorkshire County Council via a service level agreement. The Treasurer or his representative will be at the meeting to present this paper and answer any detailed questions that Members may have.

2.3 On Investments, the County Council pools the monies it invests on behalf of the Authority with its own funds and those of other organisations for which it undertakes a treasury management service. The approach adopted, consistent with the policy statement of this Authority, covered later in this report, is to ensure the security of capital and liquidity of investments. The Authority will also aim to seek the highest return on its investments provided that proper levels of security and liquidity are achieved. The approach to managing the risks associated with these activities is set out in the requirements of the various codes described in the report. The current approved lending list of banks and organisations that the Treasurer can invest in is included at the end of this report.

2.4 On borrowing as at the end of January 2014, the Authority does not have any loans in place and has not needed to borrow to fund capital projects. Despite not having taken out loans, the possibility of borrowing is an option that the Authority has ensured is available to it when making decisions on the optimum way to finance capital purchases. The indicators proposed in this report continue the practice of identifying the probable costs of replacing equipment over the coming years (e.g. ranger vehicles, photocopiers, IT Equipment etc.) and therefore establishing the necessary parameters to allow a decision to be taken to borrow funds if that proves to be the optimum solution. Nothing in the report commits the Authority to any decision to borrow funds.

2.5 The Authority is required to

(a) approve an **Annual Treasury Management Strategy (ATMS)** for 2014/15;

(b) approve an **Annual Investment Strategy** for 2014/15;

(c) approve a **Minimum Revenue Provision Policy** for 2014/15; and

(d) approve an updated set of **Prudential Indicators** for the period 2014/15 to 2016/17.

2.6 In doing so, the Authority must have regard to the following guidance, both of which were last revised in November 2011 and adopted by the Authority on 26 March 2012:

- **CIPFA Code of Practice on Treasury Management in the Public Services**
- **CIPFA Prudential Code for Capital Finance in Local Authorities**

2.7 The combined effect of these Codes and their relevant Regulations is that the Authority has to have in place by the start of the new financial year the following:

(a) An up to date Treasury Management Policy Statement;

(b) An Annual Treasury Management and Investment Strategy Statement and Minimum Revenue Provision Policy.

2.8 As noted above, the Treasury Management arrangements of the Authority are currently provided under contract by North Yorkshire County Council. The County Council is required (under this contract) to comply with the terms of this Authority's approved Treasury Management Policy Statement and Annual Treasury Management Strategy.

2.9 This report will be followed by a report to Authority in 24 March 2014 to obtain formal approval prior to the 1 April 2014.

3. **Treasury Management Policy Statement**

3.1 The CIPFA Code of Practice on Treasury Management requires the Authority to approve:

(a) a **Treasury Management Policy Statement** (TMPS) stating the policies, objectives and approach to risk management of its treasury management activities.

(b) suitable **Treasury Management Practices** (TMPs) setting out the manner in which the Authority will seek to activate the policies and objectives and prescribing how it will manage and control these activities.

3.2 Based on the requirements detailed in **paragraph 3.1(a)** above, a **Treasury Management Policy Statement** stating the Authority's policies and objectives of its treasury management activities is set out below and no changes are required.

3.3 The Authority defines the policies and objectives of its treasury management activities as follows:

(a) treasury management is the management of the Authority's investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with these activities, and the pursuit of optimum performance consistent with these risks.

(b) the successful identification, monitoring and control of risk will be the prime criteria by which the effectiveness of the treasury management activities will be measured. Accordingly the analysis and reporting of treasury management activities will focus on their risk implications for the Authority.

(c) that effective treasury management will provide support towards the achievement of the business and service objectives of the Authority. The Authority is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

3.4 As emphasised in the Treasury Management Code of Practice, responsibility for risk management and control of Treasury Management activities lies wholly with the Authority and officers of both this Authority and North Yorkshire County Council involved in Treasury Management activities are explicitly required to follow Treasury Management policies and procedures.

3.5 As referred to in **paragraph 3.1(b)** above, the CIPFA Code of Practice on Treasury Management requires a framework of Treasury Management Practices (TMPs) setting out the manner in which the Authority will seek to achieve these policies and objectives, and prescribing how it will manage these activities. The Code recommends twelve different TMPs.

3.6 As the Treasury Management activities of the Authority are carried out by North Yorkshire County Council, the approach used in previous years has been for the Authority to adopt the TMPs used by North Yorkshire County Council to govern their own Treasury Management activities. A copy of the North Yorkshire County Council TMPs is available on request.

3.7 The County Council's TMPs will be submitted to a future meeting of the Finance, Risk, Audit and Standards Committee for consideration in order to discharge their scrutiny responsibility for Treasury Management.

4. CIPFA Prudential Code for Capital Finance in Local Authorities

4.1 Under the terms of the Local Authorities (Capital Finance and Accounting) Regulations 2003, the Authority must comply with the CIPFA Prudential Code on Capital Finance in Local Authorities as updated in 2011. This requires the Authority to determine affordable borrowing limits calculated in accordance with the Code.

5. Local Authority Investments and Annual Investment Strategy

5.1 Under Section 15 (1) (a) of the Local Government Act 2003, the Authority is required to have regard to Investment Guidance issued by the Secretary of State in respect of the investment of cash funds. Updated with effect from 1 April 2012 this Guidance on Local Government Investments requires an **Annual Investment Strategy (AIS)** to be approved by Members.

5.2 In terms of an **Annual Investment Strategy** for the National Park Authority, the current contractual arrangements with North Yorkshire County Council for the investment of surplus cash balances mean that the Authority can use the AIS proposed to be adopted by the County Council on 20 February 2014. **As a result there is no need to adopt a separate document as part of the Annual Treasury Management report**.

5.3 A copy of the County Council's current AIS is available to members on request, and a copy will be available at the meeting.

5.4 The County Council's current AIS will however be submitted to a future meeting of the Finance, Risk, Audit and Standards Committee for consideration in order to discharge their scrutiny responsibility for Treasury Management.

6. Annual Treasury Management Strategy 2014/15

6.1 One of the requirements of the CIPFA Code of Practice is that an annual Treasury Management Strategy is considered and approved for each financial year.

The Strategy attached as **Appendix** includes

- the Treasury Limits in force which will limit the treasury risk and activities of the Authority
- Prudential Indicators
- The current treasury position
- the Borrowing Requirement and Borrowing Limits
- Borrowing Policy
- prospects for interest rates
- the Borrowing Strategy
- Minimum Revenue Provision Policy
- Annual Investment Strategy
- other treasury management issues

The Treasurer will report to the Authority, if and when necessary during the year, on any changes to this Annual Strategy arising from the use of operational leasing or any other innovative methods of funding.

7. Approved Lending List

7.1 The approved Lending List of Organisations (counterparties) to which the Authority may make investments, together with the maximum sum at any time that can be placed with each, is outlined in the County Council's Treasury Management Practices (TMPs) and Treasury Management Policy Statement (TMPS) as covered by the contractual arrangements with the County Council.

7.2 Any changes to the approved Lending List are made by the Treasurer under delegated powers and reported to the County Council's Executive and to the Authority as part of the reporting arrangements in **paragraph 8.2.**

7.3 The Lending List of the County Council for the 2014/15 Treasury Management and Investment Strategy is detailed in the **Schedule** to the **Appendix** (Treasury Management Strategy Statement 2014/15).

7.4 The criteria for monitoring and assessing organisations to which the Authority may make investments are incorporated into the detailed Treasury Management Practices that support the Treasury Management Policy Statement mentioned above. Applying these criteria enables the Authority to produce an Approved Lending List of organisations.

7.5 The credit rating criteria utilised since 2011/12 has reflected the significantly enhanced criteria which have developed since 2008/09 as a result of unprecedented events in the financial markets, together with continuing volatility. This approach has reflected the following:-

(a) a system of scoring each organisation using Capita's (the approved Treasury Management consultants) enhanced creditworthiness service. The service which has been progressively developed uses a sophisticated modelling system that includes:

- credit ratings published by the three credit rating agencies (Fitch, Moodys and Standard and Poor) which reflect a combination of components (Sovereign, long term, short term, individual and support)
- credit watches and credit outlooks from the ratings agencies
- Credit Default Swaps (CDS) spreads to give early warnings of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most credit worthy countries
- any known Central Government involvement or specific guarantees issued for an organisation

(b) sole reliance would not be placed on the information provided by Capita. In addition the County Council will also use market data and information available from other sources, such as the financial press and other agencies and organisations.

(c) in addition to the above, the following measures would also continue to be actively taken into consideration:

- institutions will be removed or temporarily suspended from the Approved Lending List if there are significant concerns about their financial standing or stability

- investment exposure will be concentrated with higher rated institutions wherever possible.

7.6 Utilising the approach to the assessment of credit quality detailed in **paragraph 7.5**, the criteria and investment limits for specified investments (a maximum of 364 days) are:

- institutions which are substantially owned by the UK Government (Nationalised Banks) being limited to £75m

- other institutions achieving suitable credit scores and colour bonding being limited to a maximum investment limit of between £20m and £65m (actual duration and investment limit dependent on final colour/score)

7.7 The criteria for Non Specified Investments (for periods of more than 364 days) are investments over one year to a maximum of two years with institutions which have a suitable credit score, limited to £5m with any one institution.

7.8 Local Authorities will continue to be included on the Approved Lending List for 2014/15, although suitable investment opportunities are limited. Local Authorities are classed as having the highest credit rating due to the way they are financed and their governance arrangements.

7.9 In considering the current list and changes since March 2013, it is important to bear in mind that both last year and the current list are a 'snapshot' at one point in time and do not, therefore, reflect further in year changes that may not be evident in these 'snapshots'.

(a) there are no organisations included on the 2013/14 Approved Lending List which will NOT be included for 2014/15

(b) organisations who continue to be included on the 2014/15 Approved Lending List, but whose Maximum Investment Duration will remain as nil until Credit Ratings and market sentiment improve

Organisation	**Reason**
Clydesdale Bank (Trading as the Yorkshire Bank)	Due to fall in Credit Ratings

(c) increase in lending limits for

Organisation	**Original Investment Limit (Feb 2013) £m**	**Revised Investment Limit (Apr 2013) £m**	**Revised Investment Limit (Oct 2013) £m**
Lloyds Banking Group	60	65	75
RBS Group	60	65	75
Barclays Bank	50	55	65

Limits were initially increased in April in order to be able to invest significantly high levels of cash at that time within a very short restricted Lending List. Limits were then increased again in October as part of a 'review of investments'. Although there were no immediate pressures on the Lending List at that point, the reasons for the increase were as follows:-

(i) increase exposure levels to the main 'high quality' UK banks relative to others
(ii) being prepared for cash balances increasing again
(iii) being prepared for other counterparties being suspended from the Lending List
(iv) increasing yield by being able to invest further sums for 1 year.

(d) further changes were made during the year to increase and decrease the maximum investment term for some organisations. This was the result of market movements between the Credit Default Swap and iTraxx benchmark, an early warning of likely changes to credit ratings in the future.

8. Treasury Management Reporting and Scrutiny Arrangements

8.1 The CIPFA Code of Practice on Treasury Management reflects enhanced reporting and scrutiny arrangements in terms of:

(a) each authority must receive reports on its Treasury Management policies, practices and activities, including as a minimum an annual strategy and plan in advance of the year, a mid year review and an annual outturn report after the end of the year.

(b) Treasury Management performance and policy setting should be subject to ongoing scrutiny each authority must delegate the role of scrutiny of treasury management strategy and policy to a specific named body.

8.2 These enhanced requirements have been incorporated into Financial Regulation 16 (regarding Treasury Management) with the current arrangements being as follows:-

(a) on reporting the full Authority will receive, after consideration by the Finance, Risk, Audit & Standards Committee

(i) an annual report that sets out the authority's Treasury Management Strategy, Policy and Prudential Indicator for the forthcoming financial year

(ii) an annual outturn report for both Treasury Management and Prudential Indicators setting out full details of activities and performance during the preceding year

(iii) a mid year report on Treasury Management matters including an update on Prudential Indicators

(b) on scrutiny the Authority nominated the Finance, Risk, Audit & Standards Committee (formerly the Performance Monitoring and Management Committee) to be responsible for ensuring effective scrutiny of the Treasury Management strategy, policies and day to day activities

9. Recommendations

9.1 That Members recommend to the Authority at its meeting on 24 March 2014 to:

(i) approve the Annual Treasury Management Strategy for 2014/15 as detailed in the **Appendix**, including the Prudential Indicators set out in Section 3, and the Minimum Revenue Provision policy set out in Section 9 of that Strategy.

(ii) adopt the Annual Investment Strategy agreed by the County Council for 2014/15.

(iii) approve the affordable borrowing limit of £550.9k for 2014/15, under section 3(i) of the Local Government Act 2003 as set out in Paragraph 3(iv) of the **Appendix**.

(iv) confirm the delegation to the Treasurer, as agreed in previous years, for the following matters:-

(a) any need to effect changes between the separate agreed limits for borrowing and other long term liabilities (such as finance leases) in accordance with option appraisal, value for money or other relevant factors. This applies to the Prudential Indicators in paragraph 3(iv) and 3(v) of the **Appendix**.

(b) decisions to borrow from the PWLB and money markets at the most advantageous rate, as set out in Paragraph 6.3 of the **Appendix**.

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Background papers to this Report

File ref

1. CIPFA code of Practice on Treasury Management in the Public Services.
2. CIPFA Prudential Code for Capital Finance in local authorities

APPENDIX

NORTH YORK MOORS NATIONAL PARK AUTHORITY

TREASURY MANAGEMENT STRATEGY STATEMENT 2014/15

1. Introduction

1.1 This Treasury Management Strategy statement details the expected activities of the Treasury function in the financial year 2014/15. Its production and submission to Members is a requirement of the Local Government Act 2003, the *CIPFA Treasury Management Code of Practice in the Public Sector & Prudential Code as updated.*

1.2 The suggested strategy for 2014/15 in respect of the following aspects of the treasury management function is based upon officer's views on interest rates, supplemented with market forecasts.

The strategy covers:-

- the Treasury Limits in force which will limit the treasury risk and activities of the Authority (**paragraph 2**)
- Prudential Indicators (**paragraph 3**)
- the current treasury position (**paragraph 4**)
- the Borrowing Requirement and Borrowing Limits (**paragraph 5**)
- Borrowing Policy (**paragraph 6**)
- prospects for interest rates (**paragraph 7**)
- the Borrowing Strategy (**paragraph 8**)
- Minimum Revenue Provision Policy (**paragraph 9**)
- Annual Investment Strategy (**paragraph 10**)
- other treasury management issues (**paragraph 11**)

2. Treasury Limits for 2014/15 to 2016/17

2.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the Authority to determine and keep under review how much it can afford to borrow. The amount so determined is termed **the Affordable Borrowing Limit**.

2.2 The Authority must have regard to the Prudential Code when setting the Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits. In practice, it is equivalent to the Authorised Limit as defined for the Prudential Indicators (therefore see **paragraph 3** below).

2.3 Whilst termed an Affordable Borrowing Limit, the spending plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability such as credit arrangements. The Affordable Borrowing Limit has to be set on a rolling basis for the forthcoming financial year and two successive financial years.

3. **Updated Prudential Indicators Proposed for 2014/15 to 2016/17**

3.1 The proposed Prudential Indicators for the Authority for the 2014/15 financial year are as follows.

(i) **Estimated Ratio of Capital Financing Costs to the Net Revenue Budget (Affordability)**

This indicator identifies the trend in the cost of borrowing (principal and interest) net of interest earned on temporary balances against net revenue expenditure met from National Park Grant

The estimated ratios for the current and future years and the actual figures for 2012/13 are set out in the table below. Where the interest on balances exceeds the cost of borrowing, the effective percentage is set at nil.

Year	Basis	%
2012/13	actual	0.00
2013/14	probable	0.00
2014/15	estimate	0.00
2015/16	estimate	0.18
2016/17	estimate	0.74

(ii) **Capital Expenditure Plans (Actual and Estimated)**

The actual capital expenditure that was incurred by the Authority in 2012/13 and the estimates of capital expenditure to be incurred for 2013/14 and future years are outlined in the table below.

It is important to note that this table reflects the total capital spending plans for the Authority funded by borrowing, National Park Grant and other external funding sources. All the prudential indicators that follow are based upon the possible borrowing element of these spending plans only, but do not commit the authority to using this source of finance.

Year	Basis	£k	
2012/13	actual	340.0	
2013/14	probable	175.0	
2014/15	estimate	125.0	Assumes all capital expenditure will be funded from borrowing rather than Grant or Revenue contributions
2015/16	estimate	375.0	
2016/17	estimate	125.0	

(iii) **Capital Financing Requirement and Forecast**

The capital financing requirement relates to the underlying need of the Authority to borrow to finance capital purposes. Estimates of the capital financing requirement at the future financial year end dates are as follows:-

Date	Basis	Borrowing (£k)	Other Long Term Liabilities (£k)	Total (£k)
31 March 2013	actual	0.0	178.7	178.7
31 March 2014	probable	0.0	178.6	178.6
31 March 2015	estimate	125.0	178.5	303.5
31 March 2016	estimate	475.0	178.4	653.4
31 March 2017	estimate	540.0	178.3	718.3

The above figures provide the option to allow the Authority to consider funding capital purchases by borrowing. These being £125k in 2014/15, £475k in 2015/16 and £540k in 2016/17. However the level of debt outstanding needs to be adjusted for the Minimum Revenue Provision (MRP). Details of the way in which this provision is made is covered in Section 9 below. This MRP provision applies to debt outstanding at the end of each financial year and therefore the MRP charge will be applicable from 2015/16 onwards and the capital financing requirement will be reduced accordingly.

(iv) **Authorised Limit for External Debt**

This indicator represents the limit beyond which borrowing by the Authority is prohibited, and is based upon the best estimate of increases in debt arising from the capital financing requirement plus a margin to allow some flexibility for unforeseen cash movements. This has been included at £250k.

The limit is analysed between borrowing and other long term liabilities (such as finance leases) to show the actual debt owed by the Authority and any other financing instruments that have been used.

The Treasurer has delegated authority to effect any changes between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal, value for money and any other relevant factors.

The recommended Authorised limits for external debt are as follows:

Year	Borrowing Limit £k	Other Long Term Liabilities £k	Total £k
2013/14	250.0	178.6	428.6
2014/15	375.0	178.5	553.5
2015/16	725.0	178.4	903.4
2016/17	790.0	178.3	968.3

The Treasurer can confirm that the Authorised Limit is consistent with the Authority's current commitments and budget process.

Under **Section 3(1) of the Local Government Act 2003** the Authority must determine a Statutory Limit in terms of how much money it can afford to borrow. This affordable borrowing limit must be set for the following year. The Authorised limit of £550.9k will act as this limit for 2014/15.

(v) **Operational Boundary for External Debt**

This indicator is based on the probable external debt position during the course of the year. It is not a limit and actual borrowing could vary around this boundary during the year. The difference between this indicator and the Authorised Limit is the £250k which provides headroom for unusual cash movements.

In line with the Authorised limit, the operational boundary is analysed between borrowing and other long term liabilities separately. The Treasurer has delegated authority to make in year changes to the operational boundary and its sub categories.

Year	Borrowing Limit £k	Other Long Term Liabilities £k	Total £k
2013/14	0	178.6	178.6
2014/15	125.0	178.5	303.5
2015/16	475.0	178.4	653.4
2016/17	540.0	178.3	718.3

(vi) **Actual External Debt**

This Authority had no external debt at 31 March 2013. The position as at 31 March 2014 will depend on the decisions regarding the financing of vehicles and equipment throughout the year, although at this late stage of the financial year no external borrowing has been taken and none is envisaged by 31 March 2014. For Prudential Indicators, however, other long term liabilities, such as the finance lease identified in **paragraph 3.1 (iii)**, are classed as external debt for this purpose.

(vii) **CIPFA Code Compliance**

The CIPFA Code of Practice on Treasury Management in the Public Services was last updated in November 2011 and adopted by the Authority on
26 March 2012.

(viii) **Interest Rate Exposures**

If the Authority were to borrow in 2014/15, it would follow the Borrowing Strategy set out in Section 8 of this document. Borrowing could be taken from the Public Works Loan Board (PWLB), the Government's lending agency to Local Authorities, from the money market, or from internal surplus cash balances.

A decision required by officers would be whether to take the borrowing in the form of a fixed interest rate or a variable interest rate loan. This decision would be made based on the prevailing interest rate environment at the time. A fixed rate loan is usually considered less risky than a variable loan as it gives certainty for budget purposes and it is difficult to predict future interest rate changes. However if interest rates were predicted to decrease in the short term gains could be accrued through variable rate borrowing.

To allow flexibility this indicator sets an upper limit on fixed interest rate exposures for 2014/15, 2015/16 and 2016/17 of **100%** of the authority's net outstanding principal sums. In essence all borrowings could be taken at fixed rates if required.

This indicator sets an upper limit on variable interest rate exposure for the same period at **40%** of net outstanding principal sums. This is based on advice from the County Council and reflects the riskier nature of these types of loan.

The advice of the County Council's Treasury Management Advisers is that a maximum of 20% of cash balances is invested for periods of longer than 364 days. Since investments of under 365 days are classed as variable rates, this fixes the limit of **20%** on fixed interest rate exposure for investments

If the Authority does decide to borrow the Treasurer will manage fixed interest rate exposures within the range **100%** and variable interest rate exposures within the range **-100%.** This is a continuation of the Authority's current treasury management practice. The variable interest rate limit can be negative as investments under 365 days are classed as variable and are credit balances. Therefore due to the Authority currently not holding debt, the Authority could be exposed to 100% of its investment portfolio in investments under 365 days.

Borrowing	**%age of outstanding principal sums**
Limits on fixed interest rate exposures	60 to 100
Limits on variable interest rate exposures	0 to 40
Investing	
Limits on fixed interest rate exposures	0 to 30
Limits on variable interest rate exposures	70 to 100
Combined net borrowing/investment position	
Limits on fixed interest rate exposures	160 to 210
Limits on variable interest rate exposures	-60 to -110

(ix) **Gross Debt and the Capital Financing Requirement**

The Prudential Code emphasises that in order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the proceeding year, plus the estimate of any additional capital financing requirement for the current and next two financial years.

The Treasurer can confirm that the Authority has met this requirement up to 2012/13. Furthermore, no difficulties are anticipated for the period covered by this report to 2016/17.

(x) **Maturity Structure of Borrowing**

Upper and lower limits for the maturity structure of borrowings are set to allow maximum flexibility -

Period	Lower Limit	Upper Limit
Under 12 months	0%	100%
12 months and within 24 months	0%	100%
24 months and within 5 years	0%	100%
5 years and within 10 years	0%	100%
10 years and above	0%	100%

(xi) **Total Principal Sums Invested for Periods longer than 364 days**

In line with the County Council's policy and advice in this area, a prudential indicator of **20%** of the Authority's core cash balances is recommended for investments longer than 364 days.

A maximum of 20% of funds available for investment will be held in aggregate in "Non-Specified investments" over 364 days.

4. **The Current Treasury Position**

4.1 As at 31 December 2013, the Authority's Treasury position was as shown below

Item	Principal as at 31 December 2013 £k	Average return in 2013/14 to 31 December 2013 %
External Debt Outstanding		
None	0	
Investments		
Managed by NYCC	1,293.0 *	0.72

* The figure above reflects the principal held as at 31 December 2013. The average daily balance from 1 April to 31 December 2013 was £2,163.3k.

5. **The Borrowing Requirement and Borrowing Limits**

5.1 The **Operational Boundary** reflects an estimate of the most likely, prudent but not worst case scenario of external debt during the course of the financial year. The **Authorised Limit** is based on the same estimate as the **Operational Boundary** but allows sufficient headroom over this figure to allow for unusual cash movements.

5.2 The **Authorised Limit** therefore represents the maximum amount of external debt which the Authority agrees can be incurred at any time during the financial year and includes both capital and revenue requirements. It is not, however, expected that the Authority will have to borrow up to the limit agreed.

5.3 The agreed **Operational Boundary** and **Authorised Limit** for external debt up to 2016/17 are as follows:

	Item	2013/14 estimate £k	2014/15 estimate £k	2015/16 estimate £k	2016/17 estimate £k
	Debt Outstanding at the start of the Year	0.0	0.0	125.0	475.0
+	Internal or External borrowing requirements	0.0	125.0	375.0	125.0
-	MRP charged to revenue	0.0	0.0	-25.0	-60.0
+	Long Term Liabilities	178.6	178.5	178.4	178.3
=	**Operational Boundary for year**	178.6	303.5	653.4	718.3
+	**Provision to cover unusual cash movements**	250.0	250.0	250.0	250.0
=	**Authorised Limit for year**	**428.6**	**553.5**	**903.4**	**968.3**

6. **Borrowing Policy**

6.1 The policy of the Authority is that if external borrowing is required to finance capital expenditure, then loans will be sought from the Public Works Loan Board (PWLB) or the money markets, over periods up to 70 years which reflect the best possible value to the Authority and/or the life of the Authority's assets. Individual loans are also chosen depending on the perceived value of interest rates at the time of borrowing. Consideration will be given to internal borrowing from internal cash balances. This is dealt with in more detail in **Section 8** on Borrowing Strategy.

6.2 The Treasurer, on the advice of the County Council's Treasury Management Adviser, advises that if borrowing was undertaken from the money markets then loans should be limited to 30% of the total debt portfolio.

6.3 The Authority will look to borrow from the PWLB and money markets at the most advantageous rate. The Treasurer will monitor this situation closely throughout the year to determine the most appropriate and advantageous borrowing.

6.4 The Prudential Code allows external 'borrowing for capital proposes' in advance of need with the constraints of relevant approved Prudential Indicators. There are risks, however, in such borrowing in advance of need and the Authority has not taken any such borrowing to date and there are no current plans to do so. Furthermore, the Authority will not borrow more than or in advance of need purely in order to profit from the investment of the extra sums borrowed. Any such borrowing in advance of need will only be considered where there is a clear business case for doing so for the current Capital Plan or to finance future debt maturity payments.

6.5 The merits of internal capital borrowing from the Authority's surplus cash balances also needs to be considered very carefully and this is covered in more detail in **paragraphs 8.3 to 8.9**.

7. **Prospects for Interest Rates**

7.1 Whilst recognising the continuing volatility and turbulence in the financial markets, the following paragraphs present a pragmatic and measured assessment of key economic factors as they are likely to impact on interest rates over the next three years.

7.2 In terms of the key economic background and forecasts, looking ahead the current position is as follows:

(a) **Global Economy**

- **The Eurozone (EZ)**. The sovereign debt crisis has eased during 2013 which has been a year of comparative calm after the hiatus of the Cyprus bailout in the spring. The EZ finally escaped from seven quarters of recession in quarter 1 of 2013 but growth is likely to remain weak and so will dampen UK growth. The ECB's pledge to buy unlimited amounts of bonds of countries which ask for a bailout, has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2012 figures) of 176% Greece, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Many commentators still view a Greek exit from the Euro as inevitable and there are concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks. It looks increasingly likely that Slovenia will be the next country to need a bailout.

- Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in maintaining a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy.

- **USA.** The economy has managed to return to reasonable growth in Q1 2013 of 2.5% year on year and 2.8% in Q2 in spite of the fiscal cliff induced sharp cuts in federal expenditure that kicked in on 1 March, and increases in taxation. The Federal Reserve has continued to provide huge stimulus to the economy through its $85bn per month asset purchases programme of quantitative easing. However, it is expected that this level of support will start to be tapered down early in 2014. It has also pledged not to increase the central rate until unemployment falls to 6.5%; this is probably unlikely to happen until early 2015. Consumer, investor and business confidence levels have improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have therefore been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

- **China.** Concerns that Chinese growth could be heading downwards have been allayed by recent stronger statistics. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also increasing concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

- **Japan.** The initial euphoria generated by “Abenomics”, the huge QE operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and the introduction of other economic reforms, appears to have stalled. However, at long last, Japan has seen a return to reasonable growth and positive inflation during 2013 which augurs well for the hopes that Japan can escape from the bog of stagnation and deflation and so help to support world growth. The fiscal challenges though are huge; the gross debt to GDP ratio is about 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing about Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and will fall from 128m to 100m by 2050.

(b) **The UK Economy**

- **Economic growth.** Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth stongly rebounded in 2013 - quarter 4 of 2012/13 (+0.3%), 1 (+0.7%) and Q2 of 2013/14 (+0.8%), to surpass all expectations as all three main sectors, services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts in the August and November quarterly Inflation Reports for 2013 from 1.2% to 1.6% and for 2014 from 1.7% to 2.8%, (2015 unchanged at 2.3%). The November Report stated that: -

  In the United Kingdom, recovery has finally taken hold. The economy is growing robustly as lifting uncertainty and thawing credit conditions start to unlock pent-up demand. But significant headwinds — both at home and abroad — remain, and there is a long way to go before the aftermath of the financial crisis has cleared and economic conditions normalise. That underpins the MPC’s intention to maintain the exceptionally stimulative stance of monetary policy until there has been a substantial reduction in the degree of economic slack. The pace at which that slack is eroded, and the durability of the recovery, will depend on the extent to which productivity picks up alongside demand.

Productivity growth has risen in recent quarters, although unemployment has fallen by slightly more than expected on the back of strong output growth.

So very encouraging - yes, but, still a long way to go! However, growth is expected to be strong for the immediate future. One downside is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth.

- **Forward guidance.** The Bank of England issued forward guidance in August which said that the Bank will not start to consider raising interest rates until the jobless rate (Labour Force Survey / ILO i.e. not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast to take three years in August, but revised to possibly Q4 2014 in November. The UK unemployment rate currently stands at 2.5 million i.e. 7.6 % on the LFS / ILO measure. The Bank's guidance is subject to three provisos, mainly around inflation; breaching any of them would sever the link between interest rates and unemployment levels. This actually makes forecasting Bank Rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did NOT rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour, which will mean that a significant amount of GDP growth can be accommodated without a major reduction in unemployment.

- **Credit conditions.** While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn in 2013, the Funding for Lending Scheme (FLS), aimed at encouraging banks to expand lending to small and medium size enterprises, has been extended. The FLS certainly seems to be having a positive effect in terms of encouraging house purchases (though levels are still far below the pre-crisis level), FLS is also due to be bolstered by the second phase of Help to Buy aimed at supporting the purchase of second hand properties, which is now due to start in earnest in January 2014. While there have been concerns that these schemes are creating a bubble in the housing market, the house price increases outside of London and the south-east have been minimal. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

- **Inflation.** Inflation has fallen from a peak of 3.1% in June 2013 back to the target level of 2% in December 2013.

- **AAA rating.** The UK has lost its AAA rating from Fitch and Moody's but that caused little market reaction.

(c) **Capita Asset Services forward view**

- Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds.

- There could well be volatility in gilt yields over the next year as financial markets await the long expected start of tapering of asset purchases by the Fed. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields. Equally, at the time of writing, the political deadlock and infighting between Democrats and Republicans over the budget, and the raising of the debt limit, has only been kicked down the road, rather than resolved. Resolving these issues could have a significant effect on gilt yields during 2014.

- The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

- The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

- The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see a significant increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

- Downside risks currently include:

  → UK strong economic growth is currently very dependent on consumer spending and recovery in the housing market. This is unlikely to endure much beyond 2014 as most consumers are maxed out on borrowing and wage inflation is less than CPI inflation, so disposable income is being eroded.
  → A weak rebalancing of UK growth to exporting and business investment causing a major weakening of overall economic growth beyond 2014
  → Weak growth or recession in the UK’s main trading partners - the EU and US, depressing economic recovery in the UK.
  → Prolonged political disagreement over the US Federal Budget and raising of the debt ceiling

- → A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- → A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis
- → The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- → The Italian political situation is frail and unstable; this will cause major difficulties in implementing austerity measures and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- → Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts, especially if it looks likely that one, or more countries, will need to leave the Eurozone.
- → Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- → Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

- The potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

  - → A sharp upturn in investor confidence that sustainable robust world economic growth is firmly expected, causing a surge in the flow of funds out of bonds into equities.
  - → A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
  - → UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
  - → In the longer term – an earlier than currently expected reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.

7.3 The County Council has appointed Capita Asset Services – Treasury Solutions as its treasury management advisor and part of their service is to assist in formulating a view on interest rates. By drawing together a number of current city forecasts for short term (Bank rate) and longer fixed interest rates a consensus view for bank rate, PWLB borrowing rates and short term investment rates is as follows:-

	Bank Rate	**PWLB Borrowing Rates (including 0.2% discount (para 6.3))**				**Short Term Investment Rates**	
		5 year	**10 year**	**25 year**	**50 year**	**3 Months**	**1 Year**
	%	**%**	**%**	**%**	**%**	**%**	**%**
Now	0.50	2.61	3.69	4.33	4.30	0.50	0.80
Mar 2014	0.50	2.50	3.70	4.40	4.40	0.50	0.80
June 2014	0.50	2.60	3.70	4.50	4.50	0.50	0.80

	Bank Rate	PWLB Borrowing Rates (including 0.2% discount (para 6.3))				Short Term Investment Rates	
		5 year	**10 year**	**25 year**	**50 year**	**3 Months**	**1 Year**
Sept 2014	0.50	2.70	3.80	4.50	4.50	0.50	0.80
Dec 2014	0.50	2.70	3.80	4.60	4.60	0.50	0.80
Mar 2015	0.50	2.80	3.90	4.60	4.70	0.50	0.80
June 2015	0.50	2.80	4.00	4.70	4.80	0.50	0.80
Sept 2015	0.50	2.90	4.10	4.80	4.90	0.50	1.00
Dec 2015	0.50	3.00	4.20	4.90	5.00	0.50	1.20
Mar 2016	0.50	3.10	4.30	5.00	5.10	0.50	1.40
June 2016	0.75	3.20	4.40	5.10	5.20	0.60	1.60
Sept 2016	1.00	3.30	4.50	5.10	5.20	0.70	1.80
Dec 2016	1.00	3.40	4.60	5.10	5.20	0.90	2.00
Mar 2017	1.25	3.40	4.60	5.10	5.20	1.30	2.30

7.4 Thus based on **paragraphs 7.2 and 7.3** above

Bank Rate

- UK growth prospects remain strong looking forward
- Bank of England Guidance is that interest rate rises will not be considered until the jobless rate has risen below 7% which is forecast to take three years
- thus bank rate currently set at 0.5% underpins investment returns and is not expected to start increasing until around June 2016
- it is then expected to continue to rise along with economic recovery reaching 1.25% by March 2017.

PWLB Rates

- fixed interest borrowing rates are based on UK gilt yields. The longer term trend is for gilt yields and PWLB rates will rise due to the higher volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries
- the interest rate forecasts in this report represents a balance of downside and upside risks
- PWLB borrowing interest rates have risen significantly during 2013 and are on a rising trend with a forecast to rise gradually throughout the next three years in all the periods as follows:

Period	March 2014	March 2017	Increase
	%	%	%
5 years	2.50	3.40	+ 0.90
10 years	3.70	4.60	+ 0.90
25 years	4.40	5.10	+ 0.70
50 years	4.40	5.20	+ 0.80

Short Term Investment Rates

- investment returns are likely to remain relatively low during 2014/15 and beyond
- returns are expected to increase along with bank rate increases but potentially ahead of the first bank rate increase expected around June 2016.

8. The Borrowing Strategy

8.1 Based on the interest rate forecast outlined above, there is as usual a range of options available for the borrowing strategy for 2014/15. Variable rate borrowing for PWLB loans for up to 10 years is expected to be cheaper than long term fixed rate borrowing and will, therefore, be attractive throughout the financial year compared to simply taking long term fixed rate borrowing.

8.2 The main Strategy for undertaking new borrowing will be to generally take advantage of the lowest borrowing rates available with forecast PWLB borrowing rates (see **paragraph 7.4**) for under 10 years expected to be cheaper than longer term borrowing. Under 5 years rates are expected to be lower than 5-10 year rates. The downside of such shorter term borrowing is the loss of long term stability in interest payments that longer term fixed interest rate borrowing provides. Rates are expected to gradually increase during the year so it may therefore be advantageous to take any shorter period borrowing earlier in the year.

External -v- internal borrowing

8.3 2014/15 is expected to be one of continuing historically low bank rate which provides an opportunity alternative to the borrowing strategy of external loans from the PWLB or money markets.

8.4 The Authority has cash balances. In 2013/14 there is a current daily average of £1.9m. This cash consists of cash flow generated (creditors and debtors etc); reserves, balances and provisions etc.

8.5 The existing borrowing policy does provide for such shorter term borrowing from the Authority's revenue cash balances depending on the relationship between short term variable interest rates and the fixed term PWLB or money market rates for longer periods. Consideration will, therefore, be given to the potential merits of internal borrowing and it is anticipated that the financing of the Authority's vehicles will be achieved in this way.

8.6 Over the next three years investment rates are expected to be below long term borrowing rates. A value for money assessment would indicate that value could be obtained by avoiding/delaying some or all new external borrowing and by using internal cash balances to finance new capital expenditure. This would maximise short term savings but is not risk free.

8.7 The use of such internal borrowing, which runs down investments, also has the benefit of reducing exposure to low interest rates on investments, and the credit risk of counterparties.

8.8 In considering this option, however, two significant risks to take into account are:

(a) the implications of day to day cash flow constraints and

(b) short term savings by avoiding/delaying new external borrowing in 2014/15 must be weighted against the loss of longer term interest rate stability. Thus there is the potential for incurring long term extra costs by delaying unavoidable new external borrowing until later years by which time PWLB long term rates are forecast to be significantly higher.

8.9 Against this background, the Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances - any key strategic decisions that deviate from the above will be reported to the Authority as soon as possible.

Sensitivity of the forecast

8.10 The main sensitivities of the forecast are likely to be the two scenarios below. The Treasurer will, in conjunction with the County Council's Treasury Management Adviser, continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a significant change of market view:

(i) *if it is felt that there was a significant risk of a sharp fall in both long and short term rates,* e.g. Due to the marked increase of risks around the relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short rate funding will be considered.

(ii) *if it is felt that there was a significant risk of a much sharper rise in both long and short term rates than currently forecast,* perhaps arising from a greater than expected increase in world economic activity or sudden increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheaper

9. **Minimum Revenue Provision Policy**

9.1 The statutory requirement for local authorities to charge revenue each year a specific sum for debt repayment was replaced in February 2008 with more flexible statutory guidance.

9.2 The new simple statutory duty is that a local authority shall determine for the current financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous prescriptive requirement that the minimum sum should be 4 % of the Authority's Capital Financing Requirement (CFR). The CFR consists of external debt plus capital expenditure financed by borrowing from internal sources (surplus cash balances).

9.3 Along with the above duty the Government also issued new guidance in February 2008 which requires that a Statement on the Authority's policy for its annual MRP should be submitted to the Authority for approval before the start of the financial year to which the provision will relate. The Authority are therefore legally obliged to have regard to this MRP guidance in the same way as applies to other statutory guidance such as a CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance in Investments.

9.4 The guidance is intended to enable a more flexible approach to assessing the amount of annual provision than was required under previous statutory requirements. The guidance offers four options under which MRP might be made, with an overriding recommendation that the Authority should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed). The previous system of 4% MRP did not necessarily provide that link. Although four options are described in the guidance, there is no intention to be prescriptive to make these the only options which a local authority may consider as being prudent.

9.5 The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this annual Treasury Management report.

9.6 The move to IFRS in 2010/11 involved some long term liabilities such as finance leases being brought onto balance sheets with a consequential impact on the CFR and annual MRP provision. As a result, the Danby Moors Centre is now included on balance sheet as a long term liability. This new accounting treatment impacts on the CFR mentioned in **paragraph 9.2** above with the result that an annual MRP provision is required for the finance lease. To ensure that this change has no overall financial impact on local authority budgets, the Government updated their “Statutory MRP Guidance” with effect from 31 March 2010. This updated Guidance allows MRP to be equivalent to the existing lease rental payments and the implications of this are reflected in the authority’s MRP policy for 2014/15 as set out in **paragraph 9.7** below.

9.7 The policy for 2014/15 therefore takes into account the fact that the Authority has no outstanding debt. The proposed policy is as follows.

For locally agreed Prudential Borrowing on capital expenditure incurred after 1 April 2008, MRP will be calculated based on equal annual instalments over the estimated useful life of the asset for which the borrowing is undertaken. For finance leases, MRP will be equivalent to the annual rental payable under the lease agreement.

9.8 The estimated life of relevant assets will be assessed each year based on types of capital expenditure incurred but in general will be 25 years for buildings, 50 years for land, 5 to 7 years for vehicles, plant and equipment, and 3 years for IT equipment. To the extent that expenditure is not on the creation of an asset (e.g. capital grants and loans), and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Authority.

9.9 This method of calculating the MRP is a simpler alternative to depreciation accounting. The option also allows the Authority to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy.

9.10 This policy has been used, in respect of the requirement for capital expenditure, to calculate the provisions made in the Prudential Indicators set out in section 3 of this statement.

9.11 Future annual reviews of the Authority’s MRP Policy will be undertaken and reported to Members as part of this Annual Treasury Management report.

10. Annual Investment Strategy (AIS)

10.1 The Treasury Management Contract with North Yorkshire County Council covers the day to day investment requirements of the Authority. The net return/cost achieved by the County Council officers will be closely monitored by the Treasurer. Bearing in mind the recent volatility in rates, this will allow the position relative to budget assumptions to be reviewed on a regular basis.

10.2 Within the terms of the contract the County Council continues to make all investments in accordance with the Local Government Act 2003 which requires an Annual Investment Strategy to be approved. The Authority has, therefore, adopted the Annual Investment Strategy approved by the County Council. A copy of the document is available for members on request. The information below outlines the strategy for investments.

10.3 The Authority's investment priorities are:

(i) the Authority will have regard to the revised Government Guidance on Local Government Investments, the Audit Commission's report on Icelandic Investments and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes.

(ii) the Authority's investment policy has two fundamental objectives

- the security of capital (protecting the capital sum from loss); and then
- liquidity (keeping the money readily available for expenditure when needed).

(iii) the Authority will also aim to seek the highest return (yield) on its investments provided that proper levels of security and liquidity are achieved. The risk appetite of the Authority is low in order to give priority to the security of investments

(iv) the borrowing of monies purely to invest or on-lend and make a return is unlawful and the County Council will not engage in such activity

(v) investment instruments for use in the financial year are listed under **Specified** and **Non Specified investment** categories (**see paragraphs 10.8 and 10.9**)

(vi) Counterparty Limits (which are set to secure the surplus funds the authority lends to counterparties) will be as set through the County Council's Treasury Management Practices Schedules

10.4 The County Council manages its cash balances internally, including those of this Authority.

10.5 Ongoing discussions will be held with the County Council's Treasury Management Adviser on whether to consider the appointment of fund manager(s) or continue investing in-house or any other appropriate investment opportunities.

10.6 The authority's surplus funds are invested with the County Councils funds and therefore the investment interest earned by the Authority will be from a combination of different short term investments.

10.7 Various changes have been made to the Lending List of the County Council for the 2014/15 Treasury Management and Investment Strategy and the Lending List is kept under regular review. This revised lending list, at the time of compiling this report, is detailed in **Schedule A**.

10.8 The Investment Counterparty Limits lending list for 2014/15, is divided between Specified and Non-Specified Investments. This is based on Government Guidance on Local Authority Investments which identifies investments as being either specified or non-specified.

10.9 All Specified Investments are identified by the Government as options with “relatively high security and high liquidity” requiring minimal reference in investment strategies. In this context, Specified Investments are defined as being sterling denominated, with maturities up to a maximum of 1 year meeting the minimum high credit quality.

Non-Specified Investments attract a greater potential for risk and are defined as being “those investments not meeting the definition of Specified Investments above”.

11. Other Treasury Management Issues

11.1 The Treasurer continues to monitor and assess other potential innovative methods of funding. Depending on the way these initiatives progress, it may be necessary to review the overall financing/borrowing figures included in this Strategy. The Treasurer will monitor the position as it develops throughout the year and report as necessary to the Authority.

PETER YATES
Treasurer to North York Moors National Park Authority

Central Services
County Hall
Northallerton
14 January 2014

SCHEDULE A

APPROVED LENDING LIST FOR 2014/15

Maximum sum invested at any time (The overall total exposure figure covers both Specified and Non-Specified investments) based on data as at 14 January 2014

	Country	Specified Investments (up to 1 year)		Non-Specified Investments (over 1 year)	
		Total Exposure £m	Time Limit *	Total Exposure £m	Time Limit *
UK "Nationalised" banks / UK banks with UK Central Government involvement					
Royal Bank of Scotland	GBR	75.0	364 days	-	-
Natwest Bank	GBR				
Ulster Bank Ltd	GBR				
Bank of Scotland	GBR	75.0	364 days	-	-
Lloyds TSB	GBR				
UK "Clearing Banks" and organisations covered by the UK Government guarantee of liquidity					
Santander UK plc (includes Cater Allen)	GBR	40.0	3 months	-	-
Barclays Bank	GBR	65.0	call only *	-	-
HSBC	GBR	30.0	364 days		
Clydesdale Bank (trading as Yorkshire Bank)	GBR	30.0	temporarily suspended	-	-
Nationwide Building Society	GBR	40.0	3 months	-	-
Other UK based banks and high quality Foreign Banks					
National Australia Bank	AUS	See Clydesdale above		-	-
Canadian Imperial Bank of Commerce	CAN	20.0	364 days	-	-
Deutsche Bank	DEU	20.0	3 months	-	-
Nordea Bank Finland	FIN	20.0	364 days	-	-
Credit Industriel et Commercial	FRA	20.0	6 months	-	-
BNP Paribas Fortis	FRA	20.0	3 months	-	-
Nordea Bank AB	SWE	20.0	364 days	-	-
Svenska Handelsbanken	SWE	40.0	364 days	-	-
Local Authorities					
County / Unitary / Metropolitan / District Councils		20.0	364 days	5.0	2 years
Police / Fire Authorities		20.0	364 days	5.0	2 years
National Park Authorities		20.0	364 days	5.0	2 years
Other Deposit Takers					
Money Market Funds		20.0	364 days	5.0	2 years
UK Debt Management Account		100.0	364 days	5.0	2 years

* During the latter part of December 2013, one of the assessment criteria (Credit Default Swaps – CDS) for Barclays fell outside the tolerance levels set as part of the Credit Rating Criteria. This was due to the CDS for Barclays falling marginally less than others in the market. Following consultation with the County Council's Treasury Management Advisors it was agreed to monitor these levels and place any new funds on call only – allowing funds to be withdrawn instantly.

NORTH YORKSHIRE COUNTY COUNCIL
ANNUAL INVESTMENT STRATEGY 2014/15
SPECIFIED INVESTMENTS

Investment	Security / Minimum Credit Rating	Circumstances of use
Term Deposits with the UK Government or with UK Local Authorities (as per Local Government Act 2003) with maturities up to 1 year	High security as backed by UK Government	In-house
Term Deposits with credit rated deposit takers (banks & building societies), including callable deposits with maturities less than 1 year	Organisations assessed as having "high credit quality" plus a minimum Sovereign rating of AA- for the country in which an organisation is domiciled	In-house
Certificates of Deposits issued by credit rated deposit takes (banks & building societies) up to 1 year		Fund Manager or In-house buy & hold after consultation from Treasury Management Advisor
Forward deals with credit rated banks & building societies less than 1 year (i.e. negotiated deal plus period of deposit)		In-house via a broker or direct
Money Market Funds i.e. collective investment scheme as defined in SI 2004 No 534 *These funds have no maturity date*	Fund must be AAA rated	In-house limited to £20m but as yet not used
Gilts (with maturities of up to 1 year) *Custodial arrangements prior to purchase*	Government backed	Fund Manager or In-house buy & hold after consultation from Treasury Management Advisor
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI 2004 No 534) with maturities under 12 months *Custodial arrangements required prior to purchase*		After consultation with Treasury Management Advisor

SCHEDULE B

Investment	A) Why use it ? B) Associated risks ?	Security / Minimum Credit Rating	Circumstances of use	Max % of overall investments or cash limits in each category	Maximum investment with any one counterparty	Maximum Maturity Period
Term Deposit with credit rated deposit takers (banks & building societies), UK Government and other Local Authorities with maturities greater than 1 year	A) Certainty of return over period invested which would be useful for budget purposes B) i) Not Liquid, cannot be traded or repaid prior to maturity ii) Return will be lower if interest rates rise after making deposit iii) Credit risk as potential for greater deterioration of credit quality over a longer period	Organisations assessed as having "high credit quality" Plus a minimum Sovereign rating of AA- for the country in which an organisation is domiciled	In-house via money market broker or direct	100% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£20m based on estimate for 2012/13)	£5m	2 years subject to potential future review with a maximum of no longer than 5 years
Certificates of Deposit with credit rated deposit takers (banks & building societies) with maturities greater than 1 year *Custodial arrangement prior to purchase*	A) Attractive rates of return over period invested and in theory tradable B) Market or "interest rate" risk; the yield is subject to movement during life of CD which could negatively impact on its price		Fund Manager or in-house buy & hold after consultation with Treasury Management Advisor	25% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£5m)	£3m	
Callable Deposits with credit rated deposit takers (banks & building societies) with maturities greater than 1 year	A) Enhanced Income - potentially higher return than using a term deposit with a similar maturity		To be used in-house after consultation with Treasury Management Advisor	50% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£12.5m)	£5m	

SCHEDULE C

Investment	A) Why use it ? B) Associated risks ?	Security / Minimum Credit Rating	Circumstances of use	Max % of overall investments or cash limits in each category	Maximum investment with any one counterparty	Maximum Maturity Period
	B) i) Not Liquid - only borrower has the right to pay back the deposit; the lender does not have a similar call period over which the investment will actually be held is not known at the outset ii) Interest rate risk; borrower will not pay back deposit if interest rates rise after the deposit is made					
Forward Deposits with a credit rated bank or building society > 1 year (i.e. negotiated deal period plus period of deposits	A) Known rate of return over the period the monies are invested - aids forward planning B) i) Credit risk is over the whole period not just when monies are invested ii) Cannot renege on making the investment if credit quality falls or interest rates rise in the interim period	Organisations assessed as having "high credit quality" Plus a minimum Sovereign rating of AA- for the country in which an organisation is domiciled	To be used in-house after consultation with Treasury Management Advisor	25% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£5m)	£3m	

Investment	A) Why use it ? B) Associated risks ?	Security / Minimum Credit Rating	Circumstances of use	Max % of overall investments or cash limits in each category	Maximum investment with any one counterparty	Maximum Maturity Period
Bonds issued by a financial institution that is guaranteed by the UK Government (as defined in SI 2004 No 534) with maturities in excess of 1 year *Custodial arrangements required prior to purchase*	A) i) Excellent credit quality ii) Relatively Liquid iii) If held to maturity, yield is known in advance iv) Enhanced rate in comparison to gilts B) Market or "interest rate" risk; yield subject to movement during life off bond which could impact on price	AA or Government backed	In-house on a "buy and hold" basis after consultation with Treasury Management Advisor or use by Fund Managers	25% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£5m)	N/A	2 years subject to potential future review with a maximum of no longer than 5 years
Bonds issued by Multilateral development banks (as defined in SI 2004 No 534) with maturities in excess of 1 year *Custodial arrangements required prior to purchase*	A) i) Excellent credit quality ii) Relatively Liquid iii) If held to maturity, yield is known in advance iv) Enhanced rate in comparison to gilts B) Market or "interest rate" risk; yield subject to movement during life off bond which could negatively impact on price	AA or Government backed	In-house on a "buy and hold" basis after consultation with Treasury Management Advisor	25% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£5m)	£3m	

SCHEDULE C

Investment	A) Why use it ? B) Associated risks ?	Security / Minimum Credit Rating	Circumstances of use	Max % of overall investments or cash limits in each category	Maximum investment with any one counterparty	Maximum Maturity Period
UK Government Gilts with maturities in excess of 1 year *Custodial arrangement required prior to purchase*	A) i) Excellent credit quality ii) Liquid iii) If held to maturity, yield is known in advance iv) If traded, potential for capital appreciation B) Market or "interest rate" risk: yield subject to movement during life of the bond which could impact on price	Government backed	Fund Manager	25% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£5m)	N/A	2 years subject to potential future review with a maximum of no longer than 5 years
Collateralised Deposit	A) Excellent credit quality B) i) Not Liquid, cannot be traded or repaid prior to maturity ii) Credit risk as potential for greater deterioration of credit quality over a longer period	Backed by collateral of AAA rated local authority LOBO's	In-house via money market broker or direct	100% of agreed proportion (20%) of core cash balance that can be invested for more than 1 year (£20m based on estimate for 2013/14)	£5m	

SCHEDULE C