Item 10

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

19 May 2014

Annual Treasury Management and Prudential Indicators Report 2013/14
Report of the Treasurer

1. **Purpose of the Report**

1.1 To present the results of the Treasury Management operations of the Authority for 2013/14 and the outturn position on Prudential Indicators.

2. **Background**

2.1 The Treasury Management function is concerned with:

(a) the lending and borrowing of short term funds, and

(b) the long term funding of the Authority's capital programme.

2.2 Treasury Management in this context 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 those activities; and the pursuit of optimum performance consistent with those risks'.

2.3 Members will be aware that the Treasury Management function is undertaken on behalf of the Authority by North Yorkshire County Council via a Service Level Agreement. Under the terms of this agreement 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.

2.4 The process of Treasury Management in Public Services is regulated by the **CIPFA Code of Practice on Treasury Management**. The primary requirement of the Code is the formulation and agreement by the Authority of a Treasury Management Policy Statement which sets out the parameters for the lending and borrowing of money as well as the respective responsibilities of the Authority, Performance Monitoring and Management Committee and the Treasurer.

2.5 The Code of Practice was last revised in November 2011 and adopted by the Authority on 26 March 2012.

2.6 In addition, since 1 April 2004 the Authority must also comply with the **CIPFA Prudential Code for Capital Finance in Local Authorities** (also revised in 2011) which impacts heavily on treasury management matters. The Local Government Act 2003 requires the Authority to 'have regard' to the Prudential Code and set Prudential Indicators to ensure that capital investment plans are affordable, prudent and sustainable. CIPFA introduced further changes to the 2011 Prudential Code in November 2012. The changes introduced in November 2012 did not result in a revised update of the Code being published, however the changes were reflected in the latest Prudential Code Guidance Notes issued by CIPFA in June 2013. The changes reflected in the Notes did not result in a material shift in the Guidance and did not impact on any of the Prudential Indicators.

2.7 This report is submitted under the terms of **CIPFA Code of Practice on Treasury Management** and has been prepared in the context of the Annual Treasury Management Strategy for 2013/14 approved by the Authority on 25 March 2013.

3. Treasury Management Strategy 2013/14

3.1 Under the contractual arrangements with North Yorkshire County Council for the investment of surplus cash balances the Authority adopts the investment strategy approved by the County Council. The net return/cost achieved by the County Council is closely monitored by the Treasurer.

3.2 The expectation for interest rates incorporated within the Annual Treasury Management Strategy for 2013/14 (as approved in March 2013) was prepared by the County Council with assistance from the County Council's Treasury Management Adviser and supported by a selection of City forecasts. What actually happened and/or was experienced in 2013/14 is explained in paragraph 4.1.

3.3 The interest rates for the UK were expected to be as follows:

Bank base rate was expected to remain at 0.5% until a small increase in March 2015 to 0.75%. Rates were then expected to rise along with economic recovery reaching 1.75% by March 2016. However, there was potential for the onset of bank rate increases to be delayed even further if growth proved to be weaker and slower than expected.

Longer term Public Works Loan Board (PWLB) rates were forecast to rise gradually throughout the next three years.

3.4 Based on the above, the Strategy adopted by the Authority for 2013/14 was as follows:

(a) Investment of Surplus Cash (Investment Strategy 2013/14)

The Authority's investment priorities are firstly the security of capital, and secondly the liquidity of its investments. The highest return (yield) will also be sought on investments provided that proper levels of security and liquidity are achieved. The investment risk appetite of the Authority is low in order to give priority to the security of investments.

Bearing in mind the above investment priorities the investment strategy was to maximise interest receipts by investing all cash balances until required for varying periods on the money market, commensurate with proper levels of security and liquidity.

Investments would only be made within the constraints of the approved Annual Investment Strategy (AIS).

(b) Long Term Debt to Finance Capital Expenditure (Borrowing Strategy 2013/14)

Consideration would be given to financing capital expenditure by taking borrowing from the PWLB (over periods up to 50 years) or the money markets (over a period of up to 70 years).

Depending on the relationship between short term variable interest rates and the fixed term PWLB rates for longer periods, consideration would also be given to financing capital expenditure by short term borrowing from the Authority's cash balances.

4. Borrowing and Investment Rates in 2013/14

4.1 Paragraph 3.3 above sets out the forecast for interest rates in 2013/14 as included in the Treasury Management Strategy approved in March 2013. The actual resulting interest position experienced during the year was as follows:

4.2 **Bank base rate:** From 1 April 2013 to 31 March 2014 remained at 0.5%.

4.3 **PWLB rates:** The spread on shorter term period loans was around 1.4% (between 2.5% and 3.9% for a 10 year loan) and the spread on longer term loans was in the region of 0.7% (between 3.8% and 4.5% for a 50 year loan).

4.4 **Investment Rates:** The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it to start gently rising early in 2015. This forecast rise has now been pushed back to start in late 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year.

4.5 While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate of 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below target rate for most of the two years ahead.

4.6 Gilt yields were on a sharply rising trend during 2013 as markets anticipated the start of tapering asset purchases by the Fed. This clearly started in December 2013 and The Fed adopted a future course of monthly reductions of $10bn (from a starting position of $85bn) meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during early 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral and the situation in the Ukraine caused rates to dip down reflecting a flight to quality into UK Gilts.

4.7 The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

4.8 The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget) reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018/19.

4.9 The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that stated it would do 'whatever it takes' to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some area of concern.

5. Borrowing Outturn for 2013/14

5.1 The Authority does not have any external loans in place and had no requirement to borrow in order to fund capital expenditure. Despite this position, 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 expenditure.

6. Investment Outturn for 2013/14

6.1 The Treasury Management contract with North Yorkshire County Council covers the day to day investment requirements of the Authority. The County Council operates a 'sweep' arrangement under which any surplus cash is merged with that of the County Council to secure better overall returns in the money market. Similarly if the Authority has an overnight deficit in its bank account the 'overdraft' rate based on the County Council's average investment return is cheaper than that available through the Authority's own bank facility.

6.2 The arrangement is advantageous to the Authority as day to day balances on the bank account can be volatile and unpredictable and are relatively small in terms of the levels of money market dealings. Interest is paid at the same overall average rate as earned by the County Council on the total funds loaned out.

6.3 Any loss incurred by the County Council as a result of default by a bank/building society counterparty would be apportioned between the County Council and the Authority, and other organisations operating a similar arrangement with the County Council, in proportion to the total surplus cash funds at the time of default.

6.4 The County Council currently manages its cash investments in-house, including those of the Authority and only invests with the organisations specified in the Approved Lending List. Investments were made for a range of periods from overnight to one year and were dependent on cash flow, interest rates on offer and interest rate expectations.

6.5 The only financial investments made by the County Council on behalf of the Authority were the placing of surplus funds on the money market for periods of up to one year. For the Authority the results of these placings were as follows:

Average daily balance during 2013/14	£2,106k
Interest Earned	£16.8k
Average Rate achieved 2013/14	**0.79%**

6.6 The average rate achieved by the Authority of 0.79% exceeded the 7 day benchmark rate of 0.36% (by 0.43%) and the average bank rate of 0.5% (by 0.29%).

6.7 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

7. Compliance with Treasury Limits and Prudential Indicators

7.1 Since 1 April 2004 the Authority has had to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities which impacts heavily on treasury management matters. The Local Government Act 2003 requires the Authority to ‘have regard’ to the Prudential Code and set Prudential Indicators for the next three years to ensure that capital investment plans are affordable, prudent and sustainable. A revised Prudential Code was published in November 2011 and reported to the Authority in March 2012. In November 2012 there subsequent changes to the Guidance Notes as mentioned in paragraph 2.6.

7.2 **During the financial year the Authority operated within the Treasury Limits and Prudential Indicators as set out in the Authority’s Treasury Management Policy Statement and Annual Treasury Management Strategy.**

7.3 The Prudential Indicators covering the period up to 31 March 2016 were approved by the Authority on 25 March 2013. More recently an updated set of indicators up to 31 March 2017 was approved by the Authority on 24 March 2014.

7.4 As part of this Annual Treasury Management Report for 2013/14 it is therefore appropriate to report the 2013/14 outturn position on these Prudential Indicators compared with the last updated set of indicators for the year, as approved by the Authority on 24 March 2014.

(i) **Statutory Affordable Borrowing Limit for 2013/14 required under Section 3 of the Local Government Act 2003**

	Borrowing	**Other Long Term Liabilities**	**Total**
	£k	**£k**	**£k**
Initial figure approved March 2013	250.0	178.7	428.7
Revised March 2014	250.0	178.6	428.6
Actual limit of external debt reached during 2013/14	**0**	**178.6**	**178.6**

Although the Authority had no external debt as at 31 March 2014, other long term liabilities such as the finance lease for the Danby Moors Centre are classed as external debt for the purposes of these prudential indicators. Thus, the limit set reflects sufficient headroom to cover a number of eventualities that could have occurred in the course of the financial year.

(ii) **Actual External Debt**

	Borrowing	**Other Long Term Liabilities**	**Total**
	£k	£k	£k
At 31 March 2013	0	178.7	178.7
At 31 March 2014	**0**	**178.8**	**178.6**

The Authority does not have any loans in place and has no current requirement to borrow in order to fund capital expenditure.

(iii) **Ratio of capital financing costs to the net revenue budget**

Reported March 2014	**%**
- 2012/13 actual	0
- 2013/14 probable	0
Actual 2013/14 outturn	**0**

(iv) **Capital Expenditure Actual and Forecasts**

Reported March 2014	£k
- 2012/13 actual	340.0
- 2013/14 probable	175.0
Actual 2013/14 outturn	**187.7**

Actual capital expenditure in 2013/14 related to Sutton Bank Visitor Centre (£71k), other property expenditure (£37k), vehicles (£11k) and plant and equipment (£69k). Capital expenditure was funded predominantly from within the revenue budget.

(v) **Capital Financing Requirement (as at 31 March)**

	Borrowing	**Other Long Term Liabilities**	**Total**
Reported March 2014	**£k**	**£k**	**£k**
• - 2012/13 actual	0	178.7	178.7
• - 2013/14 probable	0	178.6	178.6
Actual 2013/14 outturn	0	178.6	178.6

The Authority does not have any loans in place and has no requirement to borrow in order to fund capital expenditure.

(vi) **External Debt Limits**

	Borrowing	**Other Long Term Liabilities**	**Total**
Reported March 2014	**£k**	**£k**	**£k**
• - Authorised limit for 2013/14	250.0	178.6	428.6
• - Operational Boundary for 2013/14	0	178.6	178.6
Actual limit reached during 2013/14	0	178.6	178.6

Thus all borrowing activity in the year was within the limits set by the Authority.

(vii) **Interest Rate Exposure**

	Limits agreed March 2013 %	**Actual Position at 31/03/2014 %**
Borrowing		
Fixed	60 to 100	**0**
Variable	0 to 40	**0**
Investments		
Fixed	0 to 30	**0**
Variable	70 to 100	**100**

All investments are classified as variable because of their short term nature (i.e. less than one year).

(viii) **Maturity Structure of Borrowing**

The amount of borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Lower Limit (March 2014)	**Upper Limit (March 2014)**	**Actual at 31/03/2014**
	%	%	%
Under 12 months	0	100	0
12 months and within 24 months	0	100	0
24 months and within 5 years	0	100	0
5 years and within 10 years	0	100	0
10 years and above	0	100	0

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

The agreed maximum sum for investment longer than one year was 20% of funds available for investment but there were no such investments in place at 31 March 2014.

8. **Approved Lending List**

8.1 The credit rating criteria utilised in 2013/14 reflected the significantly enhanced criteria which have been developed since 2008/09 as a result of unprecedented events in the financial markets, followed by continuing volatility. This approach includes credit ratings published by the three credit rating agencies. Credit Default Swaps (CDS) spreads to give early warnings of likely changes in credit ratings, sovereign ratings and any known Government involvement or specific guarantees issued for an organisation.

8.2 In order to ensure sole reliance is not placed on information provided by the County Councils Treasury Management advisers, Capita Asset Services, the County Council also uses market data and information from other sources, such as the financial press and other agencies and organisations. In addition, the following measures were also taken into consideration throughout the year:

- Institutions to be removed or temporarily suspended from the Approved Lending List if there is significant concern about their financial standing.

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

- Investments were to be kept generally short.

8.3 The Approved Lending List is monitored on an ongoing daily basis and changes made as appropriate by the Treasurer to reflect changes in organisations' standings against the agreed criteria. This includes credit rating downgrades/upgrades, mergers or market intelligence, and rumours that impact on the credit rating matrix.

8.4 As a result measures were actively considered throughout the year including: removing or temporarily suspending institutions from the Approved Lending List if there was significant concern about their financial standing/stability; concentrating investment exposures to higher rated institutions wherever possible; and keeping investments short.

8.5 Changes to the Approved Lending List are reflected in the current Lending List attached as **Appendix A**.

9. Financial and Legal Implications

9.1 These implications are described in the report.

10. Recommendation

10.1 That Members note the performance of the Treasury Management operation during 2013/14 and the outturn position on Prudential Indicators.

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Background papers to this Report **File ref**

1.

Appendix A

Approved Lending List as at 28 April 2014

Maximum sum invested at any time (The overall total exposure figure covers both Specified and Non-Specified investments)

	Country	Specified Investments (up to 1 year)		Non-Specified Investments (> 1 year £12m limit)	
		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 (suspended)	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	3 months	-	-
HSBC	GBR	30.0	364 days		
Clydesdale Bank (trading as Yorkshire Bank)	GBR	30.0 (Shared with NAB)	Temporarily suspended	-	-
Nationwide Building Society	GBR	40.0	3 months	-	-
Other UK based banks and high quality Foreign Banks					
National Australia Bank	AUS	30.0 (Shared with Clydesdale)	6 months	-	-
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

* Based on data as 25 April 2014