

YORKSHIRE DALES NATIONAL PARK AUTHORITY

28 March 2006

TREASURY MANAGEMENT

Report of the TREASURER

1.0 **PURPOSE**

- 1.1 To approve an updated Treasury Management Policy Statement
- 1.2 To approve an updated Annual Treasury Management Strategy for the financial year 2006/07.
- 1.3 To provide details on the Annual Investment Strategy.

2.0 **BACKGROUND**

- 2.1 The Authority is required to adopt certain procedures in relation to Treasury Management.
- 2.2 First of all the Authority is expected to comply with the terms of the **CIPFA Code of Practice on Treasury Management in the Public Services**. This Code was substantially revised in 2001 and was adopted by the Authority on 25 March 2003.
- 2.3 In addition, the Local Government Act 2003 requires the Authority to 'have regard' to the **CIPFA Prudential Code for Capital Finance in Local Authorities**. Although this Code primarily affects borrowing its implications on other areas of Treasury Management need to be considered. This Code was adopted by the Authority on 14 March 2005, and a report to update the Prudential Indicators for the three year period up to 2008/09 is on the agenda of this meeting. These reports should be read in conjunction with each other.
- 2.4 Another implication of the Local Government Act 2003 is that the Authority is now required to set out its **Annual Treasury Management Strategy (ATMS)** and to prepare an **Annual Investment Strategy** (in accordance with ODPM guidance issued in March 2004) before the start of each financial year.
- 2.5 This report asks the Authority to approve:
 - (a) the Annual Treasury Management Strategy for 2006/07
 - (b) an updated Treasury Management Policy Statement.

- (c) the guidance from North Yorkshire County Council on an Annual Investment Strategy for the Authority.

2.6 Execution of the external Treasury Management arrangements of the Authority is 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.

3.0 CIPFA CODE OF PRACTICE ON TREASURY MANAGEMENT IN THE PUBLIC SERVICES

3.1 The adoption of the 2001 Code of Practice involved agreeing four standard clauses which have been incorporated into the Authority's Financial Regulation 13 (regarding Treasury Management). These four clauses are currently as follows:-

- (i) the Authority adopts the key recommendation of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code) 2001 as described in Section 4 of that Code.
- (ii) accordingly, the Authority will create and maintain, as the cornerstones for effective treasury management:-
 - (a) a **Treasury Management Policy Statement** (TMPS) stating the policies and objectives of its treasury management activities
 - (b) suitable **Treasury Management Practices** (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- (iii) the Authority will be responsible for the implementation and monitoring of its treasury management policies. It delegates the execution and administration of treasury management decisions to the National Park Officer (NPO) who will manage these under arrangements approved by the Treasurer and in accordance with the Authority's TMPS, associated TMPs as well as CIPFA's Standard of Professional Practice on Treasury Management.
- (iv) the Authority will receive reports on the treasury management policies, practices and activities including as a minimum, an Annual Strategy report for each financial year, and an annual report after 31st March, in the form prescribed in the TMPs.

3.2 In addition three further clauses are contained in Section 13 of the Financial Regulations. These are:-

- (i) All money in the possession of the Authority shall be under the control of the National Park Officer acting in accordance with procedures approved by the Treasurer.

- (ii) The National Park Officer shall, with the advice of the Treasurer, periodically review the Treasury Management Policy Statement and associated documentation and shall make recommendations accordingly to the Authority.
- (iii) Notwithstanding the other regulations relating to Treasury Management, the specified named posts still carry out certain responsibilities. (These are listed in Financial Regulation 13.7)

3.3 One of the above clauses (3.1(ii)(b)) requires the creation and maintenance of suitable Treasury Management Practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage those activities. The Code recommends 12 different TMPs.

As the Treasury Management activities of the Authority are carried out by North Yorkshire County Council, **the creation and maintenance of separate TMPs for this authority is not required.**

North Yorkshire County Council however has a full set of TMPs that govern their own Treasury Management activities. These can be made available for reference purposes to Members of this Authority, if required.

4.0 CIPFA PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES

- 4.1 The Authority must comply with the CIPFA Prudential Code on Capital Finance in Local Authorities from 1 April 2004 which impacts heavily on Treasury Management.
- 4.2 The framework of the new Prudential system is contained in the Local Government Act 2003 under which the Authority has a statutory duty to determine and keep under review how much it can afford to borrow. The Local Authorities (Capital Finance and Accounting) Regulations 2003 specifies the Prudential Code as the Code of Practice to which local authorities must have regard when setting and reviewing their affordable borrowing limit.
- 4.3 As a result this report should be read in conjunction with the report on 'Capital Finance and the Prudential Code' due to the interaction between the Prudential Indicators and the Treasury Management arrangements.

5.0 LOCAL AUTHORITY INVESTMENTS AND ANNUAL INVESTMENT STRATEGY

- 5.1 The Prudential Code and its regulatory framework provide a greater degree of financial freedom for local authorities. In terms of Treasury Management matters this refers to investments as well as borrowing.
- 5.2 Prior to the Prudential Code, local authority investments were governed by Regulations which gave prescriptive guidance as to which financial instruments could be used. In the interest of stewardship of public money only low risk and high liquidity products could be used (which in general should be for no longer than 364 days) on the principle that risk increases with the length of the deposit.

- 5.3 The new Capital Finance Regulations made under the 2003 Local Government Act, which incorporates the new Prudential Code system, do not cover investments and the Government has therefore issued separate Investment Guidance which authorities must now follow.
- 5.4 This Guidance was issued in March 2004 and replaces the previous prescriptive regime with a prudent but more flexible framework, which give authorities greater freedom of choice when investing surplus cash balances. The Guidance acknowledges the fact that local authorities recognise that a potentially higher return can be achieved by taking a higher degree of risk when investing surplus funds. As they already evaluate and manage many of these risks however (i.e. in terms of both credit rating and liquidity), this is not a great departure from previous practices used by local authorities.
- 5.5 Under Section 15 (1) (a) of the Local Government Act 2003, the Authority is required to have regard to guidance issued by the Secretary of State in respect of the investment of cash funds. This Guidance on Local Government Investments requires an **Annual Investment Strategy (AIS)** to be approved by Members.
- 5.6 Under the Guidance most investments that are liquid, secure and redeemable within a year, are classified as **specified investments**. Such investments will require minimal procedural formalities or qualifications other than a high credit rating.
- 5.7 Other investments that are less liquid, or will last for longer than a year, or are without a high credit rating are classed as **non-specified investments**. This will include lending to non-rated banks and building societies. Lending in non-specified investments is perfectly allowable, but a stricter assessment of the risks involved has to be undertaken.
- 5.8 In terms of an **Annual Investment Strategy** for the National Park, the current contractual arrangements with North Yorkshire County Council for the investment of surplus cash balances mean that the Authority can use the AIS adopted by the County Council on 15 February 2005. **As a result there is no need to adopt a separate document as part of the Annual Treasury Management report.**
- 5.9 It is however important that the Authority recognises the principles involved and that cash balances can now be invested for periods of longer than 364 days. Where these financial instruments are utilised, specialist advice will be taken from the County Council's Treasury Management Advisors.

A copy of the County Council's current AIS is available to members on request.

6.0 ANNUAL TREASURY MANAGEMENT STRATEGY 2006/07

- 6.1 One of the requirements of the 2001 CIPFA Code of Practice is that an annual Treasury Management Strategy (which incorporates a set of Borrowing Limits and Requirements for the year), is considered and approved for each financial year.
- 6.2 The ATMS Document for 2006/07 for the Authority is therefore attached as **Appendix A** to this report. The key elements of the Strategy are as follows:-

- (a) an overall borrowing limit of **£250k** in 2006/07.
- (b) a short term borrowing limit within the overall borrowing limit of **£250k** in 2006/07
- (c) a limit of **30%** as the proportion of the total amount of interest payable by the Authority which can be at rates varied by the lender or by external factors
- (d) 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.

6.3 (a), (b) & (c) above are considered as part of the report on Capital Finance and the Prudential Indicators elsewhere on the agenda.

7.0 TREASURY MANAGEMENT POLICY STATEMENT (TMPS)

7.1 The current Treasury Management Policy Statement (TMPS) was last updated and considered by Members on 31 May 2005 as part of the Treasury Management report for the current year. As no material changes are required to the TMPS this year, an updated version is not being submitted to Members for reapproval.

(i) **Approved Lending List**

The following changes have been made to the approved lending list based on the Treasurer's delegated powers due to changes in creditworthiness;

Deleted from long term approved list

Bayerische Hypo und Vereinsbank	}
Bayerische Landesbank Girozentrale	}
West LB AG	} Downgraded by Fitch following
Landesbank Baden-Wurttemberg	} removal of German government
HSH Nord Bank	} guarantee. Also removed from
Norddeutsche Landesbank Girozentrale	} Investec short term list.
	}
Unicredito Italiano	} Downgraded by Fitch and Moody
	} following takeover of Bayerische
	} Hypo und Vereinsbank

Addition to short term approved list

Clydesdale Bank (Trading as Yorkshire Bank) Call account

(ii) **Credit Rating criteria**

The Authority's counterparty list developed by the County Council continues to use criteria based on Fitch ICBA's credit rating system.

8.0 RECOMMENDATIONS

8.1 That Members

- (i) Approve the Annual Treasury Management Strategy for 2006/07 as detailed in **Appendix A**
- (ii) Approve the Treasury Management Policy Statement as detailed in **Paragraph 7.**
- (iii) Agree with **Para 5.8** regarding the Annual Investment Strategy and the proposed delegation arrangements

JOHN MOORE
Treasurer

Financial Services
County Hall
Northallerton

14 March 2006

YORKSHIRE DALES NATIONAL PARK AUTHORITY

TREASURY MANAGEMENT STRATEGY STATEMENT 2006/07

1.0 INTRODUCTION

- 1.1 This Treasury Management Strategy statement details the expected activities of the Treasury function in the financial year 2006/07. Its production and submission to Members is a requirement of the Authority's approved Treasury Management Policy Statement and *CIPFA Code of Practice*. Its content and structure is in the format specified in that Policy Statement.
- 1.2 The suggested strategy for 2006/07 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:-

- Treasury limits in force which limit the treasury risk and activities of the Authority **(paragraph 2)**
- Prudential Indicators **(paragraph 3)**
- borrowing requirements and limits **(paragraph 4)**
- borrowing policy **(paragraph 5)**
- prospect for interest rates **(paragraph 6)**
- borrowing strategy **(paragraph 7)**
- investment strategy **(paragraph 8)**

2.0 TREASURY LIMITS FOR 2006/07 TO 2008/09

- 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 (see **paragraph 3** below).

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

3.0 PRUDENTIAL INDICATORS FOR 2006/07 TO 2008/09

3.1 The Capital Finance & the Prudential Code report incorporated a full set of Prudential Indicators up to 2008/09, as required by the CIPFA Prudential Code for Capital Finance in Local Authorities.

3.2 These Prudential Indicators include a number relating to external debt and treasury management that should also be incorporated into the Annual Treasury Management Strategy for 2006/07.

3.4 The following Prudential Indicators are relevant for the purposes of setting an integrated treasury management strategy. Additional details on these indicators can be found within the report elsewhere on the agenda.

(i) **Estimated ratio of capital financing costs to the net revenue budget**

	%
2004/05 actual	0.0
2005/06 probable	0.0
2006/07 estimate	0.0
2007/08 estimate	0.0
2008/09 estimate	0.0

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

	£k
2004/05 actual	845.5
2005/06 probable	2222.0
2006/07 estimate	70.0
2007/08 estimate	70.0
2008/09 estimate	70.0

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

	£k
31 March 2005 actual	0.0
31 March 2006 probable	0.0
31 March 2007 estimate	0.0
31 March 2008 estimate	0.0
31 March 2009 estimate	0.0

(v) **Authorised limit for external debt**

	£k
2005/06	0.0
2006/07	250.0
2007/08	250.0
2008/09	250.0

(vi) **Operational Boundary for external debt**

	£k
2005/06	0.0
2006/07	0.0
2007/08	0.0
2008/09	0.0

(viii) **Adoption of CIPFA Code of Practice for Treasury Management in the Public Services**

The Authority agreed to adopt this code at its meeting on 25 March 2003

(ix) **Interest Rate exposures**

	%age of net outstanding principal sums
Limits on fixed interest rate exposures	70 to 100
Limits on variable interest rate exposures	0 to 30

(x) **Maturity Structure of borrowing**

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

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

(xi) **Total principal sums invested for periods 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

4.0 THE BORROWING REQUIREMENT AND BORROWING LIMITS

- 4.1 The **Operational Boundary** reflects an estimate of the most likely, but not worst case scenario of external debt during the course of the financial year. The **Authorised Limit** is based on the same estimate of the **Operational Boundary** but allows sufficient headroom over this figure to allow for unusual cash movements.
- 4.2 The **Authorised Limit** 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.
- 4.3 The agreed **Operational Boundary** and **Authorised Limit** for external debt up to 2007/08 are as follows:

Item	2005/06 probable £k	2006/07 estimate £k	2007/08 estimate £k	2008/09 estimate £k
Debt Outstanding at the start of the Year	0.0	0.0	0.0	0.0
sub total (a)	0.0	0.0	0.0	0.0
+ External borrowing requirements				
Capital financing requirement	0.0	0.0	0.0	0.0
4% MRP charged to revenue	0.0	0.0	- 0.0	- 0.0
sub total (b)	0.0	0.0	0.0	0.0
= Operational Boundary for year (a+b)	0.0	0.0	0.0	0.0
+ Provision to cover unusual cash movements	0.0	250.0	250.0	250.0
= Authorised Limit for year	0.0	250.0	250.0	250.0

5.0 BORROWING POLICY

- 5.1 The policy of the Authority is to finance capital expenditure by borrowing (from the Public Works Loan Board (PWLB) or the money markets), on average, over periods which reflect the life of the Authority's assets, or other appropriate periods. Individual loans are also chosen depending on the perceived value of interest rates at the time of borrowing.
- 5.2 Loans from the PWLB are usually very competitive when compared with other forms of borrowing reflecting prices on the gilt market for Government securities. It is therefore very unusual if the PWLB's interest rates are not the lowest available, particularly for the length of loan period involved. Exceptional circumstances do however occasionally result in comparative loans from the money markets (including

banks and building societies), having lower interest rates than PWLB loans. The Treasurer will monitor this situation closely throughout the year to determine whether at any stage, money market loans are more appropriate and advantageous to the Authority than PWLB loans.

- 5.3 Depending on the relationship between short term variable interest rates and the fixed term PWLB rates for longer periods, some capital expenditure may be financed by short term borrowing from either the Authority's revenue cash balances or external sources.

6.0 PROSPECTS FOR INTEREST RATES

- 6.1 Current city forecasts for interest rates do as usual vary considerably with a consensus view being as follows

	Base Rate %	5 year Gilt %	10 year PWLB %	25 year PWLB %	50 year PWLB %
Q1 2006	4.50	4.00	4.25	4.25	4.00
Q2 2006	4.25	4.00	4.50	4.25	4.00
Q3 2006	4.25	4.00	4.50	4.25	4.00
Q4 2006	4.00	4.25	4.50	4.50	4.25
Q1 2007	4.25	4.50	4.75	4.50	4.25
Q2 2007	4.50	4.75	4.75	4.75	4.50
Q3 2007	4.75	4.75	4.75	4.75	4.50
Q4 2007	4.75	4.75	4.75	4.75	4.50
Q1 2008	4.75	4.75	4.75	4.75	4.75
Q2 2008	4.75	4.75	4.75	5.00	4.75
Q3 2008	4.75	4.75	4.75	5.00	4.75
Q4 2008	4.75	4.75	5.00	5.00	4.75
Q1 2009	4.75	4.75	4.75	4.75	4.50

- 6.2 The above table includes 50 year PWLB rates for the first time. This extended loan period was introduced in December 2005 up to which point the maximum loan period offered by the PWLB was 30 years. Although the rates for the new 50 year loan period currently appear attractive, there are greater risks associated with borrowing for such long periods and this facility will not be used until the Treasurer has had further discussions with the County Council's Treasury Adviser.

- 6.3 The key economic forecasts, the impacts of which are reflected in the above interest rates table, include:-

UK

- GDP growth weakened from 3.2% to 1.7% in 2005 under the impact of monetary and fiscal tightening and the oil price shock depressing household spending.

Growth expected to recover weakly to about 2.0% in 2006 and then return to the long term rate of 2.5% in 2007.

- house price inflation has fallen to low levels and may now stabilise
- inflation forecast to stay around target despite hike in oil prices. The Monetary Policy Committee (MPC) is alert for pipeline cost pressures, primarily from oil price increases, feeding through into output prices and then into retail prices.
- public sector deficit to decline steadily over next few years as the Government cuts back on the rate of growth of its expenditure.

International

- there is a boom in world commodity prices driven by strong economic growth in China and India; potential for further increases in prices but supply side increases and improvements in technology are likely to reduce prices in the medium term
- inability of oil producers to spend their huge cash surpluses and reluctance of Asian economies to run current account deficits will suppress world demand and dampen world growth
- US - Fed nearing the end of its phase of measured rate raising. Fed rate may now peak at 4.5%.
- US GDP growth expected to weaken from 4.2% in 2004 to 3.5% in 2005 and 3.0% in 2006
- European Central Bank had held rates at 2% since June 2003; increase in December 2005 to 2.25 and further increases expected as the economic outlook has improved
- Eurozone GDP growth expected to rise weakly and to continue to underperform the UK and US economies.

6.4 Based on the key economic forecasts referred to above the significant interest rate predictions are:

- base rate is expected to remain at 4.50% until the end of the first quarter of 2006 before falling to 4.00% by the end of Q4 2006 and then to edge upwards during 2007 to end the year at 4.75%
- the new 50 year PWLB rate will remain flat at 4% until Q4 2006 when it will rise to 4.25% with a further increase to 4.5% in Q2 2007
- similarly the 25 to 30 year PWLB rates will remain flat at 4.25% until Q4 2006 when it will rise to 4.50% with a further increase to 4.75% in Q2 2007
- 10 year PWLB rates will stay at 4.25% in the first two quarters of 2006 but will rise to reach 4.50% in Q3 2006 and then 4.75% Q1 2007

7.0 THE BORROWING STRATEGY

7.1 Based on the prospects of interest rates outlined above, the borrowing strategy for 2006/07 should be set to take long dated borrowings in the second and third quarters of the calendar year before PWLB rates rise. This applies particularly to the new 50

year period where it is forecast the rate to remain at 4% until Q3 2006. Variable rate borrowing and borrowing in the five year area will also be attractive in the second and third quarters of the calendar year while base rate is on a falling trend.

7.2 These interest rate expectations provide options:-

- (i) with 50 year PWLB rates at 4.00% any borrowing in this area of the market should be considered in Q2 and Q3 of the calendar year (because the 50 year rates are new – see paragraph 6.1 – further discussions will take place with the Treasury Adviser). This rate will be lower than the forecast rates for shorter maturities in the 5 year and 10 year area. A suitable trigger point for considering new fixed rate long-term borrowing, therefore, would be 4.0%. However, to maintain a suitable maturity profile, short term fixed and variable borrowing should be considered as well and this should be undertaken in the second and third quarters of the financial year as the rate declines.
- (ii) borrowing longer term fixed funding should be considered if there is a risk that the average variable rate over the budget forecast period is going to be higher than the longer term fixed rate. However, over the longer term there may be periods where short term/variable rates are lower than longer term fixed rates.

7.3 Against this background caution will be adopted with the 2006-07 treasury operations. 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 at the next available opportunity.

Sensitivity of the forecast

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

- *If it is felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity, then the strategy will be re-appraised with the likely action being that fixed rate funding will be drawn whilst interest rates were still relatively cheap.*
- *If it is felt that there was a significant risk of a sharp fall in both long and short term rates, due to e.g. growth rates remaining low or weakening, then long term borrowings will be postponed, and any rescheduling from fixed rate funding into variable or short rate funding will be exercised.*

8.0 ANNUAL INVESTMENT STRATEGY (AIS)

8.1 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 also be closely monitored by the Treasurer to ensure it does not diverge from the budgeted amount.

8.2 Within the terms of the contract the County Council continues to make all investments in accordance with the Local Government Act 2003. A copy of their AIS is available for members on request outlining the strategy for temporary investments.

JOHN MOORE
Treasurer

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14 March 2006