APPENDIX A

NORTH YORKSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT POLICY STATEMENT

1.0 BACKGROUND

1.1 The County Council has adopted the **CIPFA Code of Practice on Treasury Management in the Public Services (2001).** This Code sets out a framework of operating procedures to reduce treasury risk and improve understanding and accountability regarding the Treasury position of the County Council.

1.2 The CIPFA Code of Practice on Treasury Management requires:

(a) a more truncated and strategic **Treasury Management Policy Statement** (TMPS) stating the County Council's policies and objectives for its treasury management activities.

(b) a framework of **Treasury Management Practices** (TMPs) setting out the manner in which the County Council will seek to achieve the policies and objectives set out in (a) and prescribing how it will manage and control those activities. The Code recommends 12 TMPs.

1.3 The subsequent **CIPFA Prudential Code for Capital Finance in Local Authorities**, and the terms of the **Local Government Act 2003**, establish further requirements in relation to treasury management matters, namely

(a) the approval, on an annual basis, of a set of Prudential Indicators

(b) the approval, on an annual basis, of an Annual Treasury Management Strategy and Annual Investment Strategy with an associated requirement that both are monitored on a regular basis with a provision to report as necessary both in-year and at the financial year end

1.4 This current Treasury Management Policy Statement (TMPS) was approved by County Council on 21 February 2007 following consideration by Executive on 6 February 2007.

2.0 TREASURY MANAGEMENT POLICY STATEMENT (TMPS)

2.1 Based on the requirements in **paragraph 1.2(a)** above a truncated TMPS stating the County Council's policies and objectives of its treasury management activities is set out below.

2.2 The County Council defines the policies and objectives of its treasury management activities as follows:

(a) treasury management is the management of the County Council's 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

(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 County Council

(c) that effective treasury management will provide support towards the achievement of the business and service objectives of the County Council. The County Council 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

3.0 TREASURY MANAGEMENT PRACTICES (TMPs)

3.1 As referred to in **paragraph 1.2(b)** above the CIPFA Code of Practice on Treasury Management requires a framework of treasury management practices (TMPs) which:

(a) set out the manner in which the County Council will seek to achieve the policies and objectives set out in **paragraph 2.2** above; and

(b) prescribe how the County Council will manage and control those activities.

3.2 The CIPFA Code of Practice recommends 12 TMPs and these were approved by Members on 23 March 2004.

3.3 A list of the 12 TMPs is as follows:

TMP 1	Treasury risk management
TMP 2	Best value and performance measurement
TMP 3	Decision-making and analysis
TMP 4	Approved instruments, methods and techniques
TMP 5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP 6	Reporting requirements and management information arrangements
TMP 7	Budgeting, accounting and audit arrangements
TMP 8	Cash and cash flow management
TMP 9	Money Laundering
TMP 10	Staff training and qualifications
TMP 11	Use of external providers
TMP 12	Corporate governance

4.0 PRUDENTIAL INDICATORS

4.1 The Local Government Act 2003 underpins the new Capital Finance system introduced on 1 April 2004 and requires the County Council to "have regard to" the **CIPFA Prudential Code for Capital Financial in Local Authorities**. This Code requires the County Council to set a range of Prudential Indicators for the next three years

(a) as part of the Budget process, and

(b) before the start of the financial year.

to ensure that capital spending plans are affordable, prudent and sustainable.

4.2 The Prudential Code also requires appropriate arrangements to be in place for the monitoring, reporting and revision of Prudential Indicators previously set. These arrangements were agreed by the County Council on 18 February 2004.

4.3 The Prudential Indicators are as follows

- Estimated ratio of Capital Financing costs to the net revenue budget
- Estimates of the incremental input of capital investment decisions on the Council Tax
- Capital Expenditure Actual and Forecasts
- Capital Financing Requirement and Forecast
- Authorised Limit for External Debt
- Operational Boundary for External Debt
- Actual External Debt
- Adoption of the CIPFA Code of Practice for Treasury Management
- Interest Rate Exposures
- Maturity Structure of Borrowing
- Total Principal Sums Invested for periods longer than 364 days

4.4 The County Council will approve the Prudential Indicators for a further three year period alongside the annual Revenue Budget report at its February meeting each year.

5.0 ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY

5.1 A further implication of the Local Government Act 2003 is the requirement for the County Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy (which sets out the County Council's policies for managing its investments and for giving priority to the security and liquidity of those investments).

5.2 The Government's guidance on Annual Investment Strategies issued on 12 March 2004 states that authorities could combine the Treasury Management Strategy

Statement and Annual Investment Strategy into one report. The County Council has adopted this combined approach.

5.3 The County Council's Annual Treasury Management and Investment Strategy will cover the following matters:

- treasury limits in force which will limit the treasury risk and activities of the County Council
- Prudential Indicators
- the current treasury position
- the Borrowing Requirement and Borrowing Limits
- Borrowing Policy
- prospects for interest rates
- the Borrowing Strategy
- review of long term debt
- Annual Investment Strategy
- other treasury management issues

5.4 The County Council will approve this combined Annual Strategy alongside the annual Revenue Budget report at its February meeting each year.

6.0 REVIEW OF THIS POLICY STATEMENT

6.1 Under Financial Procedure Rule 14, the Corporate Director – Finance and Central Services is required to periodically review this Policy Statement and all associated documentation. A review of this Statement, together with the associated annual strategies, will therefore be undertaken annually alongside the Revenue Budget process and at such other times during the financial year as considered necessary by the Corporate Director – Finance and Central Services.

29 January 2007

NORTH YORKSHIRE COUNTY COUNCIL

ANNUAL TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2007/08

1.0 INTRODUCTION

1.1 The Local Government Act 2003 requires the County Council to set Prudential Indicators for the next three years to ensure that the County Council's capital investment plans are affordable, prudent and sustainable.

1.2 The Act also requires the Council to set out its **Annual Treasury Management Strategy** for borrowing and to prepare an **Annual Investment Strategy** (as required by Investment Guidance issued subsequent to the Act) which sets out the County Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. For practical purposes these two strategies are combined in this document.

1.3 This Strategy document for 2007/08 therefore covers the following

- the Treasury Limits in force which will limit the treasury risk and activities of the County Council (**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**)
- review of long term debt (**paragraph 9**)
- Annual Investment Strategy (**paragraph 10**)
- other treasury management issues (**paragraph 11**)
- summary of key elements of this Strategy

1.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the County Council to produce a balanced Revenue Budget. In particular, Section 32 requires a local authority to calculate its Budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to the Revenue Budget from:-

(i) increases in interest charges caused by increased borrowing to finance additional capital expenditure, and/or

ii) any increases in running costs from new capital projects are limited to a level which is affordable within the projected revenue income of the County Council for the foreseeable future.

2.0 TREASURY LIMITS FOR 2007/08 TO 2009/10

2.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the County Council 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 County Council must have regard to the terms of the Prudential Code when setting the Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is acceptable. 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 incorporate 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.

3.0 PRUDENTIAL INDICATORS FOR 2007/08 TO 2009/10

3.1 A separate report incorporating an updated set of Prudential Indicators up to 2009/10, as required by the CIPFA Prudential Code for Capital Finance in Local Authorities, is also on the Agenda for the Executive on 6 February 2007.

3.2 These Prudential Indicators include a number relating to external debt and treasury management that should also be incorporated into this Annual Treasury Management Strategy for 2007/08. They are, however, included in the separate 6 February report referred to in **paragraph 3.1** so that a complete set of the required Prudential Indicators can be considered and approved by the County Council (on 21 February 2007) at the same time.

3.3 Further details on the Prudential Indicators below are therefore contained in the separate **Revision of Prudential Indicators** report submitted to Executive on 6 February 2007.

3.4 The following Prudential Indicators are relevant for the purposes of setting an integrated Annual Treasury Management Strategy.

(i) **Estimated ratio of capital financing costs to the net Revenue Budget**

2005/06 actual	4.4%
2006/07 probable	8.7%
2007/08 estimate	9.1%
2008/09 estimate	9.3%
2009/10 estimate	9.3%

The figures for 2006/07 and subsequent years are significantly affected by the introduction of the new Dedicated Schools Grant from 1 April 2006. This change of funding mechanism by the Government has the effect of reducing the County Council's net Revenue Budget by around 50% which results in an effective doubling of this Indicator.

(ii) **Estimates of the incremental impact of capital investment decisions on the Council Tax**

For a Band D Council Tax	**£ p**
2007/08 estimate	+1.21
2008/09 estimate	+2.61
2009/10 estimate	+3.81

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

	£m
2005/06 actual	81.5
2006/07 probable	90.8
2007/08 estimate	109.4
2008/09 estimate	77.8
2009/10 estimate	63.7

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

	£m
31 March 2006 actual	281.2
31 March 2007 probable	317.5
31 March 2008 estimate	345.4
31 March 2009 estimate	363.0
31 March 2010 estimate	382.2

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

	£m
2006/07	349.0
2007/08	387.3
2008/09	400.2
2009/10	428.8

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

	£m
2006/07	329.0
2007/08	367.3
2008/09	380.2
2009/10	408.8

(vii) **Actual External Debt**

	£m
at 31 March 2006	274.4

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

The County Council agreed to adopt this Code at its meeting on 15 May 2002 following consideration by Executive on 5 March 2002.

(ix) **Interest Rate exposures**

Borrowing	**%age of outstanding principal sums**
Limits on fixed interest rate exposures	70 to 100
Limits on variable interest rate exposures	0 to 30
Investing	
Limits on fixed interest rate exposures	0 to 20
Limits on variable interest rate exposures	80 to 100
Combined net borrowing/investment position	
Limits on fixed interest rate exposures	0 to 130
Limits on variable interest rate exposures	-30 to 25

(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.

	Lower Limit %	**Upper Limit %**
under 12 months	0	50
12 months and within 24 months	0	15
24 months and within 5 years	0	45
5 years and within 10 years	0	75
10 years and above	20	100

(xi) **Total principal sums invested for periods longer than 364 days**

A maximum of 20% of funds available for investment (both in house and externally managed) will be held in aggregate in "non specified investments" over 364 days. Based on estimated levels of funds and balances over the next three years, the need for liquidity and day to day cash flow requirements, it is forecast that £12m of the overall balances can be prudently committed to longer term investments over 364 days.

4.0 CURRENT TREASURY POSITION

4.1 The County Council's treasury portfolio position at 31 March 2006 consisted of:

Item	Principal £m	Average Rate at 31 March 2006 %
Debt Outstanding		
Fixed Rate funding		
PWLB	269.4	6.19
Variable Rate funding		
Market	5.0	3.90
Total Debt Outstanding	274.4	6.15*
Investments		
Managed in house	71.9	4.67
Managed by external fund manager	13.2	4.55
Total Investments	85.1	4.65*

(Note - * weighted figures)

5.0 THE BORROWING REQUIREMENT AND BORROWING LIMITS

5.1 The Prudential Indicators laid out in **paragraph 3** above include an Authorised Limit and Operational Boundary for external debt for each of the three years to 2009/10. These figures are summarised at **paragraphs 3.4(v) and 3.4(vi)** respectively of this Strategy.

5.2 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.

5.3 The **Authorised Limit** therefore represents the maximum amount of external debt which the County Council 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 County Council will have to borrow up to the limit agreed.

5.4 The agreed **Operational Boundary** and **Authorised Limit** for external debt up to 2009/10 are as follows:

Item	2006/07 probable £m	2007/08 estimate £m	2008/09 estimate £m	2009/10 estimate £m
Debt outstanding at start of year				
PWLB	269.4	308.7	336.5	353.8
Other Institutions	5.0			
sub total (a)	274.4	308.7	336.5	353.8
+ **External borrowing requirements**				
Capital financing requirement	45.9	40.7	31.4	37.7
Replacement borrowing	5.3	10.8	6.4	12.0
4% MRP charged to revenue	-11.6	-12.9	-14.1	-14.7
sub total (b)	39.6	38.6	23.7	35.0
- **External debt repayment** (c)	-5.3	-10.8	-6.4	-12.0
= **Forecast debt outstanding at end of year (a + b - c)**	308.7	336.5	353.8	376.8
+ **Provision for**				
Debt rescheduling	10.0	15.0	15.0	15.0
Potential capital receipts slippage	5.0	5.0	5.0	5.0
New borrowing taking place before principal repayments made	5.3	10.8	6.4	12.0
= Operational Boundary for year	**329.0**	**367.3**	**380.2**	**408.8**
+ **Provision to cover unusual cash movements**	20.0	20.0	20.0	20.0
= Authorised Limit for year	**349.0**	**387.3**	**400.2**	**428.8**

5.5 **Therefore the 2007/08 limits are as follows:**

	£m
Operational Boundary for external debt	367.3
+ provision to cover unusual cash movements during the year	20.0
= Authorised Limit for 2007/08	387.3

6.0 BORROWING POLICY

6.1 The policy of the County Council for the financing of capital expenditure is set out in Treasury Management Practice Note 3 which supports the Treasury Management Policy Statement.

6.2 In practical terms the policy is to finance capital expenditure by borrowing (from the Public Works Loan Board or the money markets) over periods up to 50 years which reflect the best possible value to the County Council and/or the life of the physical assets. Individual loans are taken out over varying periods depending on the perceived value of interest rates at the time of borrowing and to avoid a distorted loan repayment profile. Decisions to borrow are made in consultation with the County Council's Treasury Management Adviser.

6.3 Loans from the PWLB are usually very competitive with other forms of borrowing reflecting prices on the gilt market for Government securities. Access to PWLB loans since 1 April 2004 is based on the Prudential Indicators and approved 'borrowing requirements' of individual authorities. In December 2005 the PWLB introduced borrowing up to 50 years to replace the previous maximum of 30 years. In response the County Council agreed, on 25 October 2006, that the Annual Treasury Management Strategy be amended so as to allow borrowing for capital purposes for periods up to, and including, 50 years.

6.4 In addition to the PWLB the County Council can borrow from the money market (principally banks and building societies) and the financial instrument generally used for this purpose is a LOBO (Lender Option, borrower option). Such loans feature an initial fixed interest period followed by a specified series of calls when the lender has the option to request an interest rate increase. The borrower then has the option of repaying the loan (at no penalty) or accepting the higher rate.

6.5 The County Council will always look to borrow from the PWLB and money markets at the most advantageous rate. The Corporate Director – Finance and Central Services will monitor this situation closely throughout the year to determine whether at any stage, money market loans are more appropriate and advantageous to the County Council than PWLB loans.

6.6 At present all County Council long term borrowing is from the PWLB or equally advantageous money market loans although some short term money market borrowing may take place in the financial year in order to take advantage of low interest rates or to facilitate any debt restructuring exercise (see **paragraph 9** below).

6.7 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 County Council's revenue cash balances or outside sources.

7.0 PROSPECTS FOR INTEREST RATES

7.1 City forecasts for interest rates do as usual vary considerably with a current consensus view being as follows:

	Base Rate %	5 year Gilt %	10 year PWLB %	25 year PWLB %	50 year PWLB %
Q1 2007	5.50	5.25	5.00	4.50	4.25
Q2 2007	5.50	5.25	5.00	4.50	4.25
Q3 2007	5.50	5.00	4.75	4.50	4.25
Q4 2007	5.25	4.75	4.75	4.50	4.25
Q1 2008	5.00	4.50	4.50	4.50	4.25
Q2 2008	4.75	4.50	4.50	4.50	4.25
Q3 2008	4.75	4.50	4.50	4.50	4.25
Q4 2008	4.75	4.50	4.50	4.50	4.25
Q1 2009	4.50	4.50	4.50	4.50	4.25
Q2 2009	4.50	4.50	4.50	4.50	4.25
Q3 2009	4.75	4.50	4.50	4.50	4.25
Q4 2009	4.75	4.50	4.50	4.50	4.25
Q1 2010	4.75	4.50	4.50	4.50	4.25

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

UK

- GDP: the UK is on the upswing of the economic cycle from a low point reached in June 2005. Robust growth is expected to continue for a little longer but a modest cooling is expected in 2007 (2006 2.5%, 2007 2.0%) and to continue at below the trend rate of 2.5% thereafter
- recovery in consumer spending and retail sales has underpinned this upswing in GDP
- the housing market has proved more robust than expected with house price inflation at over 8% p.a.
- higher than expected immigration from Eastern Europe has strengthened growth and dampened wage inflation
- MPC decided to raise bank rate in November 2006 from 4.75% to 5% and again (surprisingly) in January 2007 to 5.25%. The MPC has been concerned that short term price increases (inflation has been significantly above target since June 2006 and reached 3% in December 2006) could feed through into wage settlements in the next pay rounds
- increases in Bank Rate in August, November 2006 and January 2007 are likely to dampen the housing market and also increases in unsecured borrowing
- inflation is expected to rise further above target in the short term which has led to the prediction of a further rate rise by March 2007 to 5.5%
- inflation is then expected to fall due to reducing energy and import prices

- household income growth to recover in 2007 as inflation falls and pay rises. But extra income likely to go into a recovery of the savings rate, pension saving and servicing debt costs (as rates rise) rather than consumer expenditure
- public sector real increase in expenditure per annum to weaken to 2.5% over the next few years from 3% average over 2000-2005
- world slowdown in growth in 2007 will dampen UK exports
- outlook: a further rate rise is predicted on the back of increasing inflation concerns. When inflation is considered back under control the bank rate will switch eventually to a falling trend to counter the negative effects of the increases on the economy end growth

International

- the US, UK and EU economies have all been on the upswing of the economic cycle in 2005 and 2006 and so have been raising interest rates in order to cool their economies and to counter inflationary pressures stimulated by high oil, gas and electricity prices which could feed through into increases in wage inflation, producer prices etc
- the US is ahead of the UK and EU in the business cycle and it looks as if their rate has probably already peaked at 5.25% whereas there is an expectation in the financial markets of further increases in the EU and UK
- the major feature of the US economy is a still steepening downturn in the housing market which is likely to drag consumer spending, and so the wider economy, down with it (e.g. house building, employment etc.). Falling house prices will also undermine household wealth and so lead to an increase in savings (which fell while house prices were rising healthily) and so conversely will lead to a fall in consumer expenditure
- the US may be reluctant to respond to the aforementioned downturn in the economy if inflationary pressures remain stubbornly high. This could exacerbate the downturn both in the US and the world economies
- EU growth picked up strongly in the first half of 2006 and is expected to remain healthy in the second half. Growth to slow moderately in 2007 due to weaker US and global demand
- despite sharply increased energy prices, disinflationary pressures from falls in prices of manufactured goods from China and India have helped to keep headline inflation in the advanced economies to an average of around 3% and will fall as the energy effects go into reverse

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

Bank Base Rate

- surprise 0.25% increase to 5.25% in January 2007
- is expected to increase again by March 2007 to 5.5% and will remain at this level until the last quarter of 2007 when it will fall to 5.25%

- further reductions to 5% in the first quarter of 2008, 4.75% in the second quarter of 2008 and 4.5% in the first quarter of 2009 are then expected before rising back to 4.75% in the third quarter of 2009

PWLB rates

- the 50 year rate is expected to remain flat at 4.25%
- 25-30 year rates are expected to remain flat at 4.5% for the foreseeable future
- 10 year rates are expected to remain at 5% until the third quarter of 2007, then falling gradually to 4.50% and remaining at that rate for the foreseeable future
- 5 year rates will remain at 5.25% until the third quarter of 2007 and then fall to 5%. A further fall to 4.75% is expected in the last quarter of 2007 followed by a reduction to 4.5% in the first quarter of 2008 with that rate remaining for the foreseeable future

8.0 THE BORROWING STRATEGY

8.1 Based on the prospects for interest rates outlined above the Borrowing Strategy for 2007/08 will be to take very long dated fixed interest rate borrowing from the PWLB or competitive money market loans at any time of the financial year. Variable rate and short period borrowing (of 5/10 year duration) is expected to be more expensive than long term borrowing and will therefore be unattractive throughout the financial year.

8.2 PWLB 50 year rates are expected to be around 4.25% throughout the financial year although small movements around this level are likely. This rate will be lower than for shorter periods and therefore borrowing should be taken in this area of the market, or equally attractive money market loans at any time of the financial year. A target rate for considering taking new fixed rate, long term borrowing will therefore be 4.25% although the aim will be to secure loans at rates below this level.

8.3 Against this background, the Corporate Director - Finance and Central Services 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 Executive at the next available opportunity.

Sensitivity of the forecast

8.4 The main sensitivities of the forecast are likely to be the two scenarios below. The Corporate Director - Finance and Central Services 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 rise in both long and short term rates,* perhaps arising from a greater than expected increase in world economic activity, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still comparatively cheaper

(ii) *If it is felt that there was a significant risk of a sharp fall in both long and short term rates,* for example due to 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 considered.

9.0 REVIEW OF LONG TERM DEBT

9.1 The long term debt position of the County Council is under continuous review.

9.2 Discussions with the County Council's Treasury Management Adviser about the long term financing strategy are ongoing and any debt rescheduling opportunity identified will be fully explored.

9.3 It is forecast that there will be opportunities during 2007/08 to restructure shorter term debt into long term debt and achieve savings. This is because of the current sharp difference between higher short term rates and cheaper long term rates. This advantage however is expected to diminish later in the year if as expected, Bank rate falls and short term rates generally also start to fall thus any such debt rescheduling should be carried out before the first fall in Bank rate expected in the last quarter of 2007. Any debt restructuring will be in accordance with the Borrowing Strategy position outlined in **paragraph 8** above.

9.4 In addition the County Council will actively give consideration during the year to taking advantage of small movements in PWLB rates to reduce the cost of existing debt by re-borrowing at lower rates without making significant changes to the type of debt (fixed/variable) or maturity periods.

9.5 The reasons for undertaking any rescheduling will include:

- the generation of cash savings at minimum risk
- in order to help fulfil the Strategy outlined in **paragraph 8** above, and
- in order to enhance the balance of the long term portfolio (ie amend the maturity profile and/or the balance of volatility)

9.6 Members will appreciate that with long term debt forecast to be £336m by the end of 2007/08 (see **paragraph 5.4**) and with an annual interest cost (net) to the Revenue Budget of about £18m the savings or additional costs, attached to even a small interest rate variation can be significant. To put this into context for every 0.1% that the interest rate can be reduced by it saves £300k pa on interest charges in the Revenue Budget. Any proposals to restructure debt or change the policy laid out earlier in this Strategy, therefore demand careful attention.

9.7 A number of opportunities to reschedule the County Council's long term debt have been implemented during 2006/07 which has achieved a significant level of ongoing revenue savings. Full details of all debt rescheduling undertaken in the 2006/07 financial year will be reported to Members as part of the Annual Treasury Management Outturn report.

9.8 The rescheduling of debt involves the early repayment of existing debt and its replacement with new borrowing. This can result in one-off costs or benefits called premiums or discounts. These occur where the rate of the loan repaid varies from comparative current rates. Where the interest rate of the loan to be repaid is higher than current rates, a premium is charged by the PWLB for repayment. Where the interest rate of the loan to be repaid is lower than the current rate, a discount on repayment is paid by the PWLB.

9.9 A current national topical issue relates to the treatment of premiums and discounts generated from carrying out debt rescheduling exercises in that:-

(i) current Regulations require debt rescheduling premiums and discounts to be spread over a number of years in the Revenue Account rather than fully in the year they were generated

(ii) CIPFA issued a draft accounting standard document (SORP) in October 2006 which included major potential changes in the treatment of the valuation of debt and investments, the calculation of interest and the treatment of premiums and discounts arising from debt rescheduling. The major area that would potentially affect the County Council would be that all premiums and discounts would have to be taken fully to the Revenue Account in the year they were generated

(iii) the Department for Communities and Local Government (DCLG) have however issued draft Regulations in December 2006 in response to the SORP which look like they will override the SORP in terms of maintaining the requirement for debt rescheduling discounts and premiums to be spread over a number of years in the revenue account

9.10 This aspect of the Annual Treasury Management Strategy will be reviewed once the final decisions in this area are known, to see whether any changes will be required in borrowing, investment or debt re-scheduling activities. Based on the draft documentation received however it is envisaged that any changes required will be minimal.

10.0 ANNUAL INVESTMENT STRATEGY

Background

10.1 Under the Local Government Act 2003 the County Council is required to have regard to Guidance issued by the Secretary of State in respect of the investment of its cash funds. This Guidance requires an Annual Investment Strategy to be approved by the County Council.

10.2 This Annual Investment Strategy must state the investments the County Council has approved for prudent management of its treasury balances during the financial year under the headings of **Specified Investments** and **Non Specified Investments**.

10.3 This section of the Strategy therefore sets out:

- the Investment Policy (**paragraph 10.4**)
- the policy regarding loans to companies in which the County Council has an interest (**paragraph 10.5**)

- security of capital and the use of credit ratings (**paragraph 10.6**)
- Specified and Non Specified Investments (**paragraph 10.7**)
- the Investment Strategy to be followed for 2007/08 (**paragraph 10.8**)
- the end of year Investment report (**paragraph 10.9**)

10.4 **Investment Policy**

(i) the County Council will have regard to the Government's Guidance on Local Government Investments (the Guidance) issued in March 2004 and CIPFA's Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code)

(ii) the County Council's investment priorities are:

- the security of capital, and
- the liquidity of its investments

(iii) the County Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity

(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 paragraph 10.7**)

(vi) Counterparty Limits will be as set through the County Council's Treasury Management Practices Schedules

10.5 **Policy regarding loans to companies in which the County Council has an interest**

(i) the County Council's general investment powers under this Annual Treasury Management and Investment Strategy come from the Local Government Act 2003 (Section 12). Under this Act a local authority has the power to invest for any purpose relevant to its functions or for the purpose of the prudent management of its financial affairs.

(ii) in addition to investment, the County Council has the power to provide loans and financial assistance to Limited Companies under the Local Government Act 2000 which introduced general powers for local authorities to do anything which it considers likely to achieve the promotion or improvement of the economy, social or environmental well being of its area. This well being power includes a power for a local authority to incur expenditure, give financial assistance to any person and to enter into arrangements with any person.

(iii) any such loans to limited companies by the County Council, will therefore be made under these 'well being powers'. They will not however be classed as investments made by the County Council and will not impact on this Investment Strategy. Instead they will be classed as capital expenditure by the County

Council under the Local Authorities (Capital Finance and Accounting) Regulations 2003, and will be approved, financed and accounted for accordingly.

10.6 **Security of capital and the use of credit ratings**

(i) the County Council will rely on credit ratings published by Fitch ICBA (one of the industry standards) to establish the credit quality (ability to meet financial commitments) of counterparties (to whom the Council lends) and investment schemes

(ii) where a counterparty does not have a Fitch rating, the equivalent Moody's rating will be used

(iii) the County Council has determined that minimum long term, short term and other credit ratings should be set for each category of investment and these are as follows:-

Period	Minimum	Highest
Short term (less than 1 year)	F2 = Good credit quality	F1+ - Highest credit quality
Long term	AA = Very high credit quality	AAA - Highest Credit quality

(iv) short term credit ratings (deposit of less than 1 year) range between F1+ (highest) to D (lowest) with F1 to F3 being low to moderate credit risk and B to D being a higher level of credit risk or default has previously occurred. As indicated above the County Council's minimum rating is F2 (good credit quality).

Long term credit ratings (deposits of more than 1 year) range between AAA (highest) to D (lowest) with AAA to BBB being low to moderate credit risk and BB to D being a higher level of credit risk or default has previously occurred. As indicated above the County Council's minimum rating is AA (very high credit quality).

The above indicates the range of both short and long term credit ratings but it should be pointed out that some organisations do not have a credit rating at all.

(v) all credit ratings will be monitored on a regular basis. The County Council is alerted to changes in Fitch ratings through its use of the Treasury Management Adviser's credit worthiness service

(vi) if a counterparty or investment scheme rating is downgraded with the result that it no longer meets the County Council's minimum criteria, the further use of that counterparty/investment scheme as a new investment will be withdrawn immediately; if an investment is already held with a counterparty whose credit rating falls below the minimum, the County Council will seek to withdraw that investment as soon as possible within the terms and conditions of the investment made

(vii) if a counterparty/investment scheme is upgraded so that it fulfils the County Council's minimum criteria the Corporate Director – Finance and Central Services will have the discretion to include it on the County Council's Approved Lending List with immediate effect

(viii) an updated list of the current counterparty lending list is attached at **Schedule A**

10.7 Specified and Non Specified Investments

(i) Investment Instruments identified for use in the forthcoming financial year are listed in the Schedules attached to this Statement under the **Specified** and **Non Specified** Investment categories

(ii) all **Specified** investments are identified by the Government as "requiring minimal procedural formalities" (see **Schedule B**). In this context the County Council has defined specified investments as being sterling denominated, with maturities up to a maximum of 1 year meeting the minimum high credit rating where appropriate

(iii) for **Non Specified** investments (see **Schedule C**) a maximum of 20% of funds available for investment (both in house and externally managed) can be held in aggregate in such investments

(iv) for both **Specified** and **Non Specified** investments, the attached Schedules indicate for each type of investment:-

- the investment category
- minimum credit rating criteria
- circumstances of use
- why use the investment and associated risks (Non Specified only)
- maximum %age of total investments (Non Specified only)
- maximum maturity period (Non Specified only)

(v) there are other instruments for both specified and non specified investments which the County Council will NOT currently use as they would need further specific advice. Examples of such investments are:-

Specified Investments
- Commercial Paper
- Gilt funds and other Bond Funds
- Treasury Bills

Non Specified Investments
- Sovereign bond issues
- Corporate Bonds
- Floating Rate notes
- Equities
- Open Ended Investment Companies
- Derivatives

10.8 **The Investment Strategy to be followed for 2007/08**

(i) the County Council currently manages its cash balances internally, although until recently an element was managed by Investec Asset Management Ltd (see **sub paragraph (ii)** below)

(ii) the County Council terminated the investment mandate with Investec Asset Management in July 2006 and recalled all cash (£13.4m) managed by this fund manager. The interest achieved had been very volatile since £10m was placed with the fund manager six years ago and the County Council's in house return exceeded that of the fund manager in four of those years. In recent years the fund manager did not achieve his own targets and has been one of the worst performing managers in this investment sector. Following discussions with the Treasury Management Adviser a decision was therefore made to recall the funds and invest in-house pending future consideration of alternative investment opportunities.

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

(iii) the County Council’s cash balances consist of two basic elements. The first element is **cash flow derived** (debtors/creditors/timing of income compared to expenditure profile). The second **core element relates to specific funds and balances** (reserves, provisions, balances, capital receipts, funds held on behalf of other organisations etc)

(iv) having given due consideration to the County Council’s estimated level of funds and balances over the next three financial years, the need for liquidity and day to day cash flow requirements it is forecast that a maximum of £12m (previously £10m) of the overall balances can be prudently committed to longer term investments (eg between 1 and 3 years)

(v) investments will accordingly be made with reference to this core element and the County Council’s cash flow requirements and the outlook for short term interest rates (ie rates for investments up to 12 months)

(vi) the County Council currently has two non specified investments over 365 days totalling £5m as follows:-

- ➔ £3m invested with the Royal Bank of Scotland on 30 November 2006 at a fixed interest rate of 5.45% for three years but the bank has the option of repaying at the end of each year (callable deposit)
- ➔ £2m invested with the Alliance and Leicester Bank on 30 November 2006 at a fixed interest rate of 5.35% for two years (fixed interest deposit)

(vii) the interest rate outlook is for a further increase in bank rate to 5.5% in February 2007, followed by a falling trend from the fourth quarter of 2007 reaching 4.5% by the first quarter of 2009 (see **paragraph 7.1** above). The County Council will therefore seek to lock in longer term investments at higher rates for some of its investment portfolio (which represents its core balances) before the fall starts. A rate in excess of 5.5% has been determined as an attractive trigger for one, two and three year deposits given the expectation that the bank rate will peak at 5.5%. This trigger point will be kept under review and discussed with the Treasury Management Adviser so that investments can be made at the appropriate time

(viii) for its cash flow generated balances the County Council will seek to utilise 'business reserve accounts' (deposits with certain banks and building societies) and short dated deposits (overnight to three months) in order to benefit from the compounding of interest

10.9 **End of Year Investment Report**

At the end of the financial year a report on the County Council’s investment activity will be submitted to Members as part of the Annual Treasury Management Outturn Report.

11.0 OTHER TREASURY MANAGEMENT ISSUES

Operational leasing

11.1 Up to 2004/05 the County Council used operational leasing to acquire plant and vehicles. The main reason was that such financing did not impact on the level of capital resources (capital receipts and Government Credit approvals) otherwise available to the County Council. However this rationale does not apply from 1 April 2004 because under the Prudential Code there is now the option of undertaking additional unsupported borrowing to finance such items.

11.2 There is of course still the option to finance by operational leasing and the use of leasing for periods greater than one year is approved within the schedule of Treasury Management Practices which support the County Council’s Treasury Management Policy Statement. The Financial Procedure Rules of the County Council require that the Corporate Director – Finance and Central Services shall undertake the negotiation of all leasing arrangements.

11.3 A detailed option appraisal on whether to operationally lease, finance lease or fund from borrowing will therefore be undertaken each year as it may be the case that the best value option will change over time (eg as market conditions fluctuate). A recent in house option appraisal has indicated that borrowing was the best value option for 2006/07 and therefore the purchase of plant, vehicles and equipment estimated at £1m for 2006/07 will be financed from Prudential borrowing with consequential financing costs being recharged to Directorates in lieu of lease rentals.

11.4 The capital value of plant, equipment and vehicles to be purchased in 2007/08 is estimated to be £0.8m and a further option appraisal will be carried out during the year to determine whether financing should be through leasing or Prudential borrowing.

Other issues

11.5 The County Council continues to monitor potential PFI opportunities and assess other 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 Corporate Director - Finance and Central Services will monitor the position as it develops throughout the year and report as necessary to the Executive.

12.0 SUMMARY OF KEY ELEMENTS OF THIS STRATEGY

12.1 For the financial year 2007/08 the County Council approves the following:-

(a) an Authorised Limit for external debt of £387.3m in 2007/08

(b) an Operational Boundary for external debt of £367.3m in 2007/08

(c) a borrowing limit on fixed interest exposures of between 70% to 100% of outstanding principal sums and a limit on variable interest rate exposures of between 0 to 30% of outstanding principal sums

(d) an investment limit on fixed interest exposures of 0 to 20% of outstanding principal sums and a limit on variable interest rate exposure of between 80% to 100% of outstanding principal sums

(e) a limit of 20% (estimated at £12m) of the total cash sums available for investment (both in house and externally managed) to be invested in Non Specified investments over 364 days

(f) the Corporate Director - Finance and Central Services to report to the County Council if and when necessary during the year on any changes to this Strategy arising from the use of operational leasing, PFI or other innovative methods of funding

JOHN MOORE
Corporate Director – Finance and Central Services

29 January 2007

SPECIFIED AND NON-SPECIFIED INVESTMENTS COUNTERPARTY LIMITS FOR 2007/08

Maximum sum invested at any time (The overall total exposure figure covers both Specified [up to 1 year] and non-specified investments [over 1 year])		Specified Investments (up to 1 year) Total Exposure £m	Non-Specified Investments Total Limit £10M (over 1 year) Total Exposure £m
Category 1 - Banks			
UK Clearing Banks and UK based banks, approved by the Bank of England, and classified as a minimum of F1 (short term) and AA (long term) or equivalent for £15m short term and £5m long term.			
Abbey		15.0	5.0
Alliance and Leicester		15.0	5.0
Barclays Bank/Woolwich		15.0	5.0
HBOS (Halifax, Bank of Scotland)		15.0	5.0
Lloyds/TSB Group		15.0	5.0
HSBC (Midland Bank)		15.0	5.0
Northern Rock plc (F1 only)		15.0	-
Royal Bank of Scotland / Nat West Bank / Ulster Bank		15.0	5.0
Bradford & Bingley (F1 only)		15.0	-
Clydesdale Bank (Trading as Yorkshire Bank)		15.0	5.0
Credit Suisse International		15.0	5.0
(b) *High Quality Foreign Banks classified as a minimum of F1 (short term) and AA (long term) or equivalent for £8m short term and £5m long term.*			
National Australia Bank	Australia	8.0	5.0
Dexia Banque – Belgium	Belgium	8.0	5.0
Allied Irish Bank	Eire	8.0	5.0
Anglo Irish Bank (F1 only)	Eire	8.0	-
Bank of Ireland / Bristol & West	Eire	8.0	5.0
Depfa	Eire	8.0	5.0
Banco Bilbao Vizcaya	Spain	8.0	5.0
Rabobank	Netherlands	8.0	5.0
Dresdner	Germany	8.0	-
EBS	Eire	8.0	-
ING	Netherlands	8.0	5.0
Category 2 – Building Societies			
Minimum of F1 (short term) and AA (long term) or equivalent.			
Britannia		8.0	-
Chelsea		8.0	-
Cheshire		8.0	-
Coventry	F1 only	8.0	-
Derbyshire		8.0	-
Dunfermline		8.0	-
Leeds		8.0	-
Nationwide		8.0	5.0
Portman		8.0	-
Principality		8.0	-
Skipton		8.0	-
Yorkshire	F1 only	8.0	-
Newcastle		8.0	-
West Bromwich		8.0	-
Norwich & Peterborough		8.0	-

	Specified Investments (up to 1 year) Total Exposure £m	Non-Specified Investments Total Limit £10M (over 1 year) Total Exposure £m
Category 3 - Local Authorities		
(a) *Group 1*		
County Councils English Unitary Councils Metropolitan District Councils	5.0	5.0
(b) *Group 2*		
District Councils Police Authorities Fire Authorities National Park Authorities	2.5	2.5
Category 4 - Other Deposit Takers		
New investments added in April 2002 - The Local Authorities (Capital Finance and Approved Investments) (Amendment) (England) Regulations 2002 (SI 2002/451)		
(a) Money Market Funds with highest possible rating (AAA) for that fund type, by at least one of the three major credit rating agencies (Moody's, Standard and Poor, Fitch)	5.0	5.0
(b) UK Government Debt Management Account Deposit Facility ('AAA' rated)	2.5	2.5

Notes:

1) Note that the total of specified investments is limited only by the amount of surplus cash balances whereas non-specified investments have a total limit of £10M.

2) All Exposure limits apply to NYCC only following the recall of funds from the Fund Manager.

3) The overall total exposure to any counterparty is £15M for UK clearing banks, and £8M for quality foreign banks and UK building societies. This is the same as their maximum specified investments exposure. If any non-specified investments are made the short term exposure needs to be reduced accordingly with that Counterparty.

4) It should also be noted that the Nationwide is the only Building Society with a long term credit rating and as such is the only one that can be considered for non-specified investments

NORTH YORKSHIRE COUNTY COUNCIL

ANNUAL INVESTMENT STRATEGY 2007/08

SPECIFIED INVESTMENTS

All the specified Investments listed below must be sterling denominated, redeemable within 364 days, and represent share or loan capital.

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 one year	High security as Government backed.	In-house
Term Deposits with credit rated deposit takers (banks & building societies), including callable deposits with maturities less than one year	Fitch's short term of F1 & F2	In-House
Certificates of Deposit issued by credit rated deposit takers (banks & building societies) up to 1 Year	Fitch's short term of F1 & F2	Fund Manager/In-House
Money Market Funds i.e. a collective investment scheme as defined in SI 2004 No 534. *These funds do not have any maturity date*	Yes - AA	In house – limited to £5M but as yet not used
Gilts (with maturities up to 1 year) *Custodial arrangements prior to purchase*	Govt backed	Fund Manager
Forward deals with credit rated banks and building societies less than 1 year (i.e. negotiated deal plus period of deposit)	Fitch's short term of F1 & F2	In house via Brokers
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 arrangement required prior to purchase*	Govt backed	Only after consultation with Sector

NORTH YORKSHIRE COUNTY COUNCIL

ANNUAL INVESTMENT STRATEGY 2007/08

NON-SPECIFIED INVESTMENTS

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 and 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 the deposit (iii) Credit risk as potential for greater deterioration of credit quality over longer period	Long term – AA	In-house via money market brokers	100% of core cash balances (£12m based on estimate for 2007/08)	£5m	No longer than 5 years
Certificates of Deposit with credit rated deposit takers (banks and 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	Long term – AA	Fund Manager	25% of core cash balances (£3m)	£3m	No longer than 5 Years
Callable deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year.	(A) Enhanced Income – potentially higher return than using a term deposit with a similar maturity (B) (i) Not liquid – only borrower has the right to pay back the deposit; the lender does not have a similar call (ii) period over which the investment will actually be held is not known at the outset (iii) Interest rate risk; borrower will not pay back deposit if interest rates rise after the deposit is made	Long term - AA	To be used in-house after consultation with Sector	50% of core cash balances (£6m)	£5m	No longer than 5 Years

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) (i) Market or 'interest rate' risk: yield subject to movement during life of the bond which could impact on price	Govt backed	Fund Manager	25% of core cash balances (£3m)	N/A	No longer than 1 Year
Forward Deposits with credit rated banks and building societies > 1 year (i.e. negotiated deal period plus period of deposit)	(A) (i) 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 the monies are invested (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period	Long term - AA	To be used in-house after consultation with Sector	25% of core cash balances (£3m)	£3m	No longer than 5 Years
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 arrangement required prior to purchase*	(A) (i) Excellent credit quality (ii) relatively liquid (iii) if held to maturity the yield is known in advance (iv) enhanced rate in comparison to gilts (B) (i) Market or 'interest rate' risk: yield subject to movement during life of bond which could impact on price	AA or govt backed	In house on a 'buy and hold' basis after consultation with Sector	25% of core cash balances (£3m)	N/A	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 arrangement required prior to purchase*	(A) (i) Excellent credit quality (ii) relatively liquid (iii) if held to maturity the yield is known in advance (iv) enhanced rate in comparison to gilts (B) (i) Market or 'interest rate' risk: yield subject to movement during life of bond which could negatively impact on price	AA or govt backed	In house on a 'buy and hold' basis after consultation with Sector	25% of core cash balances (£3m)	£3m	No longer than 5 Years

Note: NYCC has a maximum limit on non-specified investments of 20% of its overall cash balances – estimated at £12m for 2007/08