

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

North Hertfordshire District Council
2013/14

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1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

“The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. In addition, Cabinet will receive quarterly update reports.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Cabinet. This role is undertaken by the Finance, Audit and Risk Committee.

1.3 Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

The training needs of members and treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Council uses Sector as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2013/14 – 2015/16

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans.

| Capital expenditure £m | 2011/12 Actual £'000 | 2012/13 Estimate £'000 | 2013/14 Estimate £'000 | 2014/15 Estimate £'000 | 2015/16 Estimate £'000 |
|--|----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Advances & Cash Incentives | 67 | 1,105 | 570 | 605 | 605 |
| Asset Management | 169 | 296 | 385 | 77 | |
| CCTV | 6 | 4 | | | |
| Community Services | 36 | 130 | | | |
| Computer Software & Equipment | 212 | 140 | 110 | 34 | |
| Growth Fund Projects | 324 | 573 | 215 | | |
| Housing | | 1,000 | | | |
| Leisure Facilities | 2,370 | 1,639 | 2,181 | 150 | |
| Museum & Arts | 27 | 150 | 2,430 | 1,560 | |
| Parking | 341 | 617 | 758 | 92 | |
| Renovation & Reinstatement Grant Expenditure | 810 | 780 | 780 | 780 | 780 |
| Waste Collection | | | 1,000 | | |
| Town Centre Enhancement | 422 | 72 | | 100 | |
| Total | 4,784 | 6,506 | 8,429 | 3,398 | 1,385 |

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need which will be met by a drawdown of cash investments.

| Capital expenditure £m | 2011/12 Actual £'000 | 2012/13 Estimate £'000 | 2013/14 Estimate £'000 | 2014/15 Estimate £'000 | 2015/16 Estimate £'000 |
|--|----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Total | 4,784 | 6,506 | 8,429 | 3,398 | 1,385 |
| Financed by: | | | | | |
| Capital receipts | | 429 | 1,803 | 630 | 630 |
| Government grants | 906 | 939 | 470 | 255 | 255 |
| IT Reserve | | 93 | 76 | | |
| Revenue | 36 | 88 | | | |
| Other Capital Contributions | 1,788 | 313 | 404 | 1,500 | |
| Net financing need for the year | 2,054 | 4,644 | 5,676 | 1,013 | 500 |

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.611m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

| £'000 | 2011/12 Actual | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|--------------------------------------|-------------------|---------------------|---------------------|---------------------|---------------------|
| Capital Financing Requirement | | | | | |
| CFR | -34,878 | -30,234 | -24,558 | -23,545 | -23,045 |
| Movement in CFR | 2,054 | 4,644 | 5,676 | 1,013 | 500 |

| Movement in CFR represented by | | | | | |
|--|--------------|--------------|--------------|--------------|------------|
| Net financing need for the year (above) | 2,054 | 4,644 | 5,676 | 1,013 | 500 |
| Less MRP/VRP and other financing movements | 0 | 0 | 0 | 0 | 0 |
| Movement in CFR | 2,054 | 4,644 | 5,676 | 1,013 | 500 |

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

NHDC has a negative CFR, therefore there is no need to make an MRP in the General Fund.

NHDC are participating in the Local Authority Mortgage Scheme (LAMS). £500K has been deposited with both Leeds Building Society and Lloyds TSB. The mortgage lenders require a five year deposit from the local authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement

(CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

| Year End Resources £'000 | 2011/12 Actual £'000 | 2012/13 Estimate £'000 | 2013/14 Estimate £'000 | 2014/15 Estimate £'000 | 2015/16 Estimate £'000 |
|-----------------------------|----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Fund balances / reserves | 2,288 | 2,102 | 2,240 | 2,211 | 2,193 |
| Capital receipts | 1,197 | 768 | 1,430 | 3,900 | 3,270 |
| Provisions | 722 | 722 | 722 | 722 | 722 |
| Total core funds | 4,207 | 3,592 | 4,392 | 6,833 | 6,185 |
| Expected investments | 47,860 | 47,100 | 43,000 | 43,000 | 43,000 |

2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.6 Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| % | 2011/12 Actual | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|---|-------------------|---------------------|---------------------|---------------------|---------------------|
| | -5.31% | -6.04% | -4.42% | -3.91 | -3.70 |

The estimates of financing costs include current commitments and the proposals in this budget report. The figures are negative because NHDC receives a greater amount of investment interest than it pays loan interest.

2.7 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. Any shortfall in

capital funding will be met by a drawdown on cash investments. The table below shows the likely impact on the General Fund and the incremental impact of Capital investment on Council Tax.

Incremental impact of capital investment decisions on Council Tax

| | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|--|-----------------------------|-----------------------------|-----------------------------|
| Loss of investment interest in General Fund | £70,000 | £85,000 | £15,000 |
| Equivalent increase in Council Tax | 0.7% | 0.85% | 0.15% |

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2012, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

| £'000 | 2011/12 Actual | 2012/13 Estimate | 2013/14 Estimate | 2014/15 Estimate | 2015/16 Estimate |
|--|-------------------|---------------------|---------------------|---------------------|---------------------|
| External Debt | | | | | |
| Debt at 1 April | 5,044 | 4,892 | 2,265 | 1,660 | 1,573 |
| Expected change in Debt | -152 | -2,627 | -605 | -87 | -57 |
| Other long-term liabilities (OLTL) | 0 | 0 | 0 | 0 | 0 |
| Expected change in OLTL | 0 | 0 | 0 | 0 | 0 |
| Actual gross debt at 31 March | 4,892 | 2,265 | 1,660 | 1,573 | 1,516 |
| The Capital Financing Requirement | -34,878 | -31,692 | -25,981 | -24,759 | -24,644 |
| Under / (over) borrowing | (4,892) | (2,265) | (1,660) | (1,573) | (1,516) |

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed

| Operational boundary | 2012/13 Estimate £'000 | 2013/14 Estimate £,000 | 2014/15 Estimate £,000 | 2015/16 Estimate £'000 |
|-----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Debt | 8,000 | 6,000 | 6,000 | 6,000 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 8,000 | 6,000 | 6,000 | 6,000 |

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

| Authorised limit | 2012/13 Estimate £'000 | 2013/14 Estimate £'000 | 2014/15 Estimate £'000 | 2015/16 Estimate £'000 |
|-----------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Debt | 10,000 | 8,000 | 8,000 | 8,000 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 10,000 | 8,000 | 8,000 | 8,000 |

3.3 Prospects for interest rates

The Council has appointed Sector as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table reflects the Sector central view.

| Annual Average % | Bank Rate | PWLB Borrowing Rates (including certainty rate adjustment) | | |
|---------------------|-----------|---|---------|---------|
| | | 5 year | 25 year | 50 year |
| Dec 2012 | 0.50 | 1.50 | 3.70 | 3.90 |
| March 2013 | 0.50 | 1.50 | 3.80 | 4.00 |
| June 2013 | 0.50 | 1.50 | 3.80 | 4.00 |
| Sept 2013 | 0.50 | 1.60 | 3.80 | 4.00 |
| Dec 2013 | 0.50 | 1.60 | 3.80 | 4.00 |
| March 2014 | 0.50 | 1.70 | 3.90 | 4.10 |
| June 2014 | 0.50 | 1.70 | 3.90 | 4.10 |
| Sept 2014 | 0.50 | 1.80 | 4.00 | 4.20 |
| Dec 2014 | 0.50 | 2.00 | 4.10 | 4.30 |
| March 2015 | 0.75 | 2.20 | 4.30 | 4.50 |
| June 2015 | 1.00 | 2.30 | 4.40 | 4.60 |
| Sept 2015 | 1.25 | 2.50 | 4.60 | 4.80 |
| Dec 2015 | 1.50 | 2.70 | 4.80 | 5.00 |
| March 2016 | 1.75 | 2.90 | 5.00 | 5.20 |

The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history, although the economy returned to positive growth in the third quarter of 2012. Growth prospects are weak and consumer spending, the usual driving force of recovery, is likely to remain under pressure due to consumers focusing on repayment of personal debt, inflation eroding disposable income, general malaise about the economy and employment fears.

The primary drivers of the UK economy are likely to remain external. 40% of UK exports go to the Eurozone so the difficulties in this area are likely to continue to hinder UK growth. The US, the main world economy, faces similar debt problems to the UK, but urgently needs to resolve the fiscal cliff now that the Presidential elections are out of the way. The resulting US fiscal tightening and continuing Eurozone problems will depress UK growth and is likely to see the UK deficit reduction plans slip.

This challenging and uncertain economic outlook has several key treasury management implications:

- Investment returns are likely to remain relatively low during 2013/14 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time.

3.4 Borrowing strategy

The Council is currently maintaining an over-borrowed position. This is because the Council has both a negative CFR and outstanding debt. This is due to the legacy of outstanding debt after the receipt of income from the sale of the housing stock. Debt has not been repaid early as the premium for early redemption is extremely expensive. Outstanding debt will continue to reduce over time as loans reach maturity which means that this indicator will show as “over borrowed” for the foreseeable future.

Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Strategic Director of Finance, Policy and Governance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The CFR as at the 1st April 2013 is estimated to be a negative £31.692M. Where the CFR is nil or negative on the last day of the financial year, this indicates that the Authority's provision for debt is equal to or greater than the debt incurred. There is accordingly no need to make a Minimum Revenue Provision in the following year. Without a significant increase in the amount of borrowing it is estimated the Capital Financing Requirement will remain negative during 2014/15 and 2015/16. The CFR requirement of a local authority will increase whenever capital expenditure is incurred and not resourced immediately (from useable capital receipts, direct charge to revenue or capital grant) and represents an increase in the underlying need to borrow for a capital purpose. This will be the case whether or not external borrowing actually occurs.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

| | 2013/14 £'000 | 2014/15 £'000 | 2015/16 £'000 |
|---|------------------|------------------|------------------|
| Interest rate exposures | | | |
| | Upper | Upper | Upper |
| Limits on fixed interest rates based on net debt | -39,105 | -39,609 | -39,697 |
| Limits on variable interest rates based on net debt | -11,731 | -11,883 | -11,909 |
| Limits on fixed interest rates: | | | |
| • Debt only | 2,265 | 1,659 | 1,572 |
| • Investments only | -41,369 | -41,269 | -41,269 |
| Limits on variable interest rates | | | |
| • Debt only | 679 | 498 | 472 |
| • Investments only | -12,411 | -12,381 | -12,381 |
| Maturity structure of fixed interest rate borrowing 2013/14 | | | |
| | | Lower | Upper |
| Under 12 months | | 48% | 100% |
| 12 months to 2 years | | 7% | 100% |
| 2 years to 5 years | | 9% | 100% |
| 5 years to 8years | | 4% | 100% |
| 8 years and above | | 32% | 100% |
| Maturity structure of variable interest rate borrowing 2013/14 | | | |
| | | Lower | Upper |
| Under 12 months | | 0% | 100% |
| 12 months to 2 years | | 0% | 100% |
| 2 years to 5 years | | 0% | 100% |
| 5 years to 10 years | | 100% | 100% |
| 10 years and above | | 0% | 100% |

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Cabinet, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list.

Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments and counterparty limits identified for use in the financial year are listed below in 4.2.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Strategic Director of Finance, Policy and Governance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary.

NHDC will use Fitch ratings to identify the risk associated with each counterparty. (Credit rating information is also supplied by Sector, our treasury consultants). Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers by Sector almost immediately after they occur and this information is considered before dealing.

In light of the collapse of the Icelandic banks, NHDC will continue the policy to not invest any funds in non UK banks. From recent experiences the UK Government has been willing to assist troubled institutions in the UK and as such, the amount of risk to the Council of investing in UK banks is considered less than investing in non UK banks. NHDC will only lend to UK banks with a credit rating for longer term deals greater than “BBB” and F3 or above for short term credit ratings. (These are Fitch definitions of ratings).

The criteria for providing a pool of high quality investment counterparties is:

- Banks 1 - good credit quality – the Council will only use banks which:
 - i. are UK banks;
 and have, as a minimum, the following Fitch, credit ratings:
 - i. Short term – F3
 - ii. Long term – BBB
- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks will be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Banks 4 - UK Banks wholly owned subsidiaries -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies

Not all building societies are credit rated but this will not preclude them from the lending list if they fulfil the criteria below. (Building societies have to pay the credit rating agency to obtain a rating). Where a society does have a credit rating, this will be considered at the time of the deal taking into account the amount of investment and the length of the deal.

The Council will use all societies which:

 - i. Have assets in excess of £0.3bn
- Money market funds – AAA rated
- UK Government (including gilts and the DMADF)
- Other Local authorities
- Local Authority Mortgage Scheme. Under this scheme the Council is required to place funds of £500K, with Leeds Building Society and Lloyds TSB for a period of 5 years. This is classified as being a

service investment, rather than a treasury management investment, and is therefore outside of the specified / non specified categories.

| | Total Maximum Amount of Investment | | | |
|---|---|-------------------------|-----------------------|---------------------|
| | £9 Million | £9 Million | £6 Million | £4 Million |
| UK Clearing Banks with a credit rating greater than BBB | All | | | |
| UK Clearing Banks – Wholly owned Subsidiaries with a credit rating greater than BBB | | All | | |
| AAA rated Money Market Funds | | All | | |
| Building Societies | Assets £4.5bn | Assets £2.5bn to £4.5bn | Assets £1bn to £2.5bn | Assets £0.3bn- £1bn |
| Public Corporations | All | | | |
| Other Local Authorities | All | | | |

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

As well as imposing maximum limits with each counterparty, the overall percentage of outstanding investments with each counterparty will be assessed to ensure a reasonable spread of investments.

4.3 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2014. Bank Rate forecasts for financial year ends (March) are:

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

The estimated investment interest for 2013/14 is approximately £0.696M. This has been calculated using an average interest rate of 1.0% for new deals made during the year for the Cash Managers and 0.86% In House.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

| Maximum principal sums invested > 364 days | | | |
|--|----------------|----------------|----------------|
| £m | 2013/14 | 2014/15 | 2015/16 |
| Principal sums invested > 364 days | £20m | £20m | £20m |

Cash Managers will continue to be permitted to invest for longer than 364 days. A maximum of £20M in total may be invested longer than 364 days with a maximum term of 5 years. All decisions made on long term investments will be made in conjunction with Officers and will be dependant on market conditions and cashflow. Deals longer than two years will require approval by the S151 Officer.

4.4 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.5 Cash Managers

It is proposed that the current arrangements whereby investments are split between two external Cash Managers and In-House continue. The Council's Cash Managers will comply with the Annual Investment Strategy.

The maximum levels for 2013/14 are as follows:

| | |
|------------------------|-----------------------|
| External Cash Managers | £23 Million Sterling |
| External Cash Managers | £23 Million Tradition |
| Managed In House | £22 Million |

The value managed In House will be used to control daily cash flow and monitor internal performance with the Cash Managers. The levels of funds split between the Cash Managers and In House will be monitored throughout the year to ensure there are sufficient funds maintained In House to meet all cash flow requirements. If funds are required, the level placed with the Cash Managers will be reduced and managed In House.