

**Denbighshire County Council**

**Treasury Management Strategy Statement  
and Investment Strategy 2014/15 to 2016/17**

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# Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17

## 1 Background

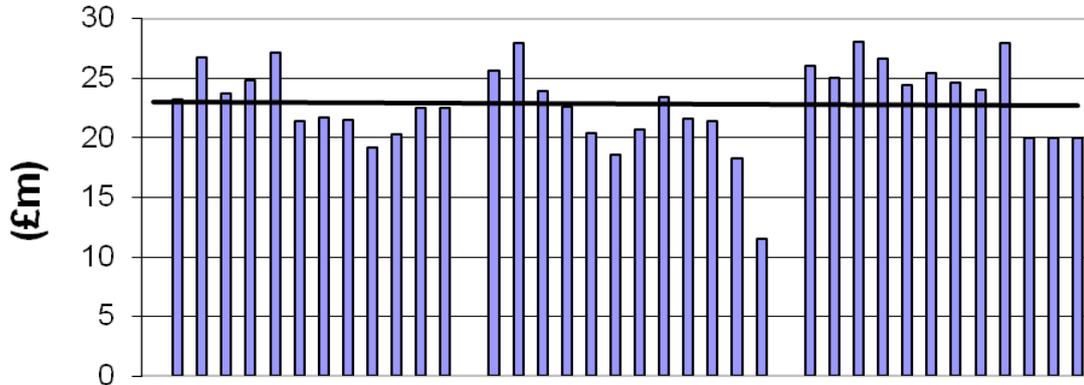
- 1.1 The Council is responsible for its Treasury Management decisions and activity which involves looking after the Council's cash. This is a vital part of the Council's work because approximately £0.5bn passes through the Council's bank account every year.
- 1.2 On 28 February 2012 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy statement (TMSS) before the start of each financial year.
- 1.3 In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in April 2010 that requires the Authority to approve an investment strategy before the start of each financial year.
- 1.4 This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.
- 1.5 The purpose of the TMSS is to set the:
  - Treasury Management Strategy for 2014/15
  - Annual Investment Strategy for 2014/15
  - Prudential Indicators for 2014/15, 2015/16 and 2016/17 (**Annex A**)
  - Minimum Revenue Provision (MRP) Statement

## 2 Treasury Position

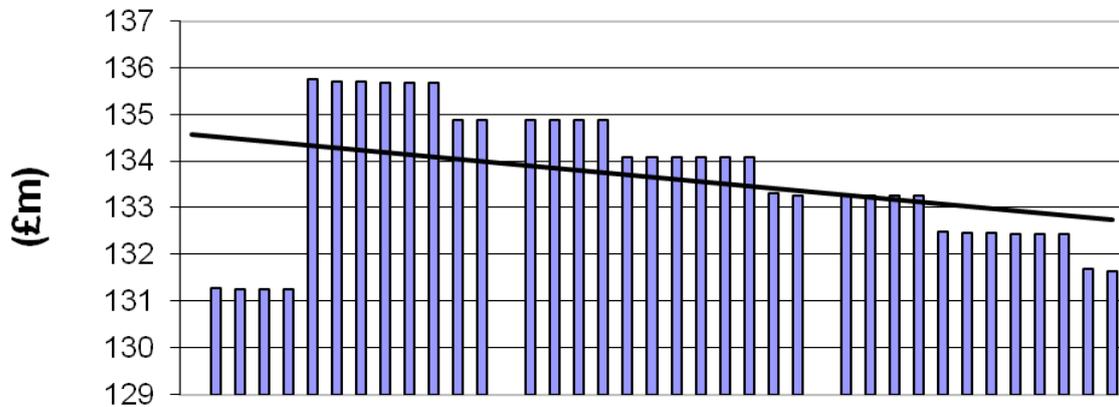
- 2.1 The levels of the Council's investment and borrowing balances over the last three years are shown in the graphs below. The first chart shows that the amount of money we have to invest has remained fairly constant over the last three years. The second shows the Council's borrowing has decreased over the course of the last three years as we have relied on internal borrowing as much as possible instead of undertaking external borrowing from the Public Works Loan Board (PWLb).

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**Investment Balances (2011/12 - 2013/14)**



**Borrowing Balances (2011/12 - 2013/14)**



**3 Investment Strategy**

- 3.1 Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority’s objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
- 3.2 The Authority may invest its surplus funds with any of the counterparties in table 1 below, subject to the cash and time limits shown.

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**Table 1: Approved Investment Counterparties**

Counterparty	Cash limit	Time limit
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	10 years
	AA+	5 years
	AA	4 years
	AA-	3 years
	A+	2 years
	A	1 year
	A-	
The Authority's current account bank (Natwest Bank Plc) if it fails to meet the above criteria	£4m	next day
UK Central Government (irrespective of credit rating)	unlimited	50 years
UK Local Authorities (irrespective of credit rating)	£8m each	10 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher	£5m each	10 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings	£5m each	5 years
UK Building Societies without credit ratings	£1m each	1 year
Money market funds and other pooled funds	£3m each	n/a
Any other organisation, subject to an external credit assessment and specific advice from the Authority's treasury management adviser	£1m each	1 year

- 3.3 This strategy aims to diversify our investments across a larger number of financial institutions which will reduce our current reliance on a limited number of UK banks. This action is being taken because of a lower likelihood that the UK and other governments will support failing banks in the future. As the Banking Reform Act 2014 is implemented, banks will no longer be able to rely on bail-outs and they will be expected to stand on their own feet. This increases the risk to large investors such as local authorities who may be required to provide a proportion of the amount required to cover the bank's losses in the event of default. This new risk has been termed 'bail-in' risk and is potentially a greater risk to investors than the 'bail-out' risk of the past.
- 3.4 Consequently, for a group of banks under the same ownership, the banking group limit will now be equal to the individual bank limit. This is a reduction in our previous limit which was set at 1.5 times the individual bank limit.
- 3.5 As a result of an improvement in the housing market and a strengthening of building societies' balance sheets, the 2014/15 strategy will add a number of building societies to our investment list which will help us to spread our investments over a larger number of financial institutions. This will include

## **Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17**

building societies without credit ratings where an external credit assessment by our treasury advisers, Arlingclose Ltd, shows them to be suitably creditworthy.

- 3.6 The Authority's current account is held with Natwest Bank Plc which is currently rated at the minimum A- rating in table 1. Should the credit rating fall below A-, the Authority may continue to deposit surplus cash with Natwest Bank Plc providing that investments can be withdrawn on the next working day, and that the bank maintains a credit rating no lower than BBB- (the lowest investment grade rating).
- 3.7 The Authority uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
  - any existing investments that can be recalled or sold at no cost will be, and
  - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 3.8 The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices (the cost of banks insuring themselves against default), financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 3.9 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will

## Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17

cause a reduction in the level of investment income earned, but will protect the principal sum invested.

The reduction in investment income which the Council has suffered over the last five years is illustrated in Table 2 below:

**Table 2: Investment Income**

2008/09 Interest £000	2009/10 Interest £000	2010/11 Interest £000	2011/12 Interest £000	2012/13 Interest £000
2,219	635	239	408	398

3.10 **Specified Investments:** The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

3.11 **Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement; those that are defined as capital expenditure by legislation, such as shares in money market funds and other pooled funds; and investments with bodies and schemes not meeting the definition of high credit quality. Limits on non-specified investments are shown in table 3 below.

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**Table 3: Non-Specified Investment Limits**

	<b>Cash limit</b>
Total long-term investments	£10m
Total shares in money market funds	£10m
Total shares in other pooled funds	£10m
Total investments without credit ratings or rated below A-	£10m
Total investments in foreign countries rated below AA+	£10m
Total non-specified investments	£20m

3.12 **Approved Instruments:** The Authority may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits where the Authority may demand repayment at any time (with or without notice),
- callable loans where the borrower may demand repayment at any time,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

## **4 Borrowing Strategy**

4.1 Borrowing strategies continue to be influenced by the relationship between investment and borrowing rates. The interest rate forecast provided in **Annex B** indicates that an acute difference between investment and borrowing rates is expected to continue. This difference creates a “cost of carry” for any new longer term borrowing where the proceeds are temporarily held as investments because of the difference between what is paid on the borrowing and what is earned on the investment.

4.2 In view of this, the strategy which has been in place for some time now has been to reduce our investment balances and rely on internal borrowing as much as possible instead of external borrowing from the Public Works Loan Board (PWLB). This has been sustainable because the level of the Council’s balances and reserves has been sufficient to avoid the need for external borrowing.

## **Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17**

- 4.3 However, as the Corporate Plan is now progressing, we intend to review this strategy and begin to undertake new borrowing. Borrowing rates are also expected to rise so the intention is to borrow to take advantage of the lower rates which are available currently. Although this will create a cost of carry in the short term while the proceeds are temporarily held as investments, we will save in the long term because of the anticipated increase in borrowing rates which will result in higher interest costs if we delay.
- 4.4 While the Council can borrow from a number of banks, it normally only borrows from the Public Works Loan Board (PWLB) which is a Government body that lends to public sector organisations.

The approved sources of borrowing are listed below:

- PWLB
- UK local authorities
- any institution approved for investments
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues.

### **5 Debt Rescheduling**

- 5.1 The Council is able to pay off loans earlier than we have to and to replace them with cheaper loans in order to save money or to reduce the risk to the Council. Sometimes, we will replace these loans and sometimes not, depending on market conditions and interest rates.
- 5.2 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt rescheduling although occasional opportunities arise.

### **6 Minimum Revenue Provision (MRP) Statement**

- 6.1 The Council sets aside money each year to repay debt and this is known as the Minimum Revenue Provision (MRP). In 2014/15, this will be £8.2m.
- 6.2 There are four different methods of calculating MRP and the Council needs to say each year which methods it will use. This is known as the MRP Statement.

## **Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17**

- 6.3 The MRP Statement will be submitted to Council before the start of the 2014/15 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement will be put to Council at that time.

### **6.4 MRP Statement**

The Council will apply the Regulatory Method for supported capital expenditure which means that MRP is charged at 4% of the Council's Capital Financing Requirement.

The Council will apply the Asset Life Method for unsupported capital expenditure which means that MRP is determined by the life of the asset for which the borrowing is undertaken.

The different methods of calculation will affect how much money the Council sets aside for debt repayment. The above statement means that where the Welsh Government gives us the money to repay debt we will repay it at 4% of whatever is outstanding. Where we borrow through Prudential Borrowing we will charge an amount that lets us repay the debt over the expected life of the asset.

- 6.5 Adopting International Financial Reporting Standards (IFRS) has resulted in leases and Private Finance Initiative (PFI) schemes coming on the balance sheet. This affects how much it appears the Council has borrowed but this is effectively covered by grant payments. MRP in respect of leases and PFI schemes brought on the balance sheet under IFRS will match the annual principal repayment for the associated deferred liability. This is a technical accounting adjustment which is cost neutral for the Council.
- 6.6 MRP on Housing assets is made in accordance with statutory requirements (the General Determination of the Item 8 Credit and Item 8 Debit).

## **7 Reporting Treasury Management Activity**

The Section 151 Officer (Head of Finance & Assets) will report to the Corporate Governance Committee on treasury management activity / performance as follows:

(a) The Treasury Management Strategy Statement and Prudential Indicators will be submitted to the committee in January each year prior to approval by Council.

(b) Two treasury management updates will be submitted to the committee in January and September each year.

(c) An annual report on treasury activity will be submitted to the committee in September each year for the preceding year prior to approval by Cabinet.

A treasury update showing the latest investment and borrowing position will be included in the monthly Revenue Monitoring report and borrowing will also be reported on in the Capital Plan to Council.

## **Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17**

### **8 Other items**

#### **8.1 Member Training**

The CIPFA Code of Practice on Treasury Management requires the Section 151 Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

The Council has nominated the Corporate Governance Committee as the committee which has responsibility for scrutiny of the treasury management function. Annual training requirements will be agreed with the Corporate Governance Committee.

#### **8.2 Treasury Management Consultants**

The Council uses Arlingclose Ltd as Treasury Management Consultants and receives the following services:

- Credit advice
- Investment advice
- Borrowing advice
- Technical accounting advice
- Economic & interest rate forecasts
- Workshops and training events

The Council maintains the quality of the service with its advisors by holding quarterly strategy meetings and tendering every 5 years. Following a recent tendering exercise, the contract was renewed with Arlingclose from 01 January 2014 for three years with an option to extend for a further two year period.

#### **8.3 Housing Revenue Account Subsidy Reform**

The Welsh Government is in negotiations with HM Treasury regarding the reform of the HRA subsidy system in Wales. Details of the precise mechanism & timing are not available at this stage. The authority will monitor developments in this area as further details become available. It is likely the changes will be implemented from 2015/16.

#### **8.4 Policy on Use of Financial Derivatives**

In the absence of any legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

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**ANNEX A**

**PRUDENTIAL INDICATORS 2014/15 TO 2016/17**

**1 Background**

The indicators are calculated to demonstrate that the Council's borrowing is affordable and are underpinned by the following regulations. There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

**2 Gross Debt and the Capital Financing Requirement**

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Section 151 Officer reports that the Council had no difficulty meeting this requirement in 2013/14 to date nor are there any difficulties envisaged in future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

**3 Estimates of Capital Expenditure**

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

<b>Capital Expenditure</b>	<b>2013/14 Approved £000</b>	<b>2013/14 Revised £000</b>	<b>2014/15 Estimate £000</b>	<b>2015/16 Estimate £000</b>	<b>2016/17 Estimate £000</b>
Council Fund	29,727	30,559	23,903	5,027	4,571
Corporate Plan – Approved		7,139	2,246		
Corporate Plan – Proposed	6,603		11,649	34,083	29,102
HRA	9,182	7,384	6,178	5,179	5,335
<b>Total</b>	<b>45,512</b>	<b>45,082</b>	<b>43,976</b>	<b>44,289</b>	<b>39,008</b>

The Corporate Plan has been divided in the table above between those elements which have been approved and those which are proposed at this stage. The indicators below incorporate both elements of the Corporate Plan.

## Treasury Management Strategy Statement and Investment Strategy 2014/15 to 2016/17

3.2 Capital expenditure will be financed as follows:

<b>Capital Financing</b>	<b>2013/14 Approved £000</b>	<b>2013/14 Revised £000</b>	<b>2014/15 Estimate £000</b>	<b>2015/16 Estimate £000</b>	<b>2016/17 Estimate £000</b>
<b>Council Fund</b>					
Capital Receipts	1,738	1,451			
Grants & Contributions	14,016	19,740	9,015	1,868	1,841
Revenue Contributions & Reserves	1,009	1,175	729		
Supported Borrowing	6,846	4,196	5,702	2,909	2,730
Prudential Borrowing	6,118	3,997	8,457	250	
	<b>29,727</b>	<b>30,559</b>	<b>23,903</b>	<b>5,027</b>	<b>4,571</b>
<b>Corporate Plan</b>					
Capital Receipts		400			588
Grants & Contributions	990	1,200	2,834	12,252	6,207
Revenue Contributions & Reserves	2,505	1,213	1,976	7,245	4,844
Supported Borrowing	1,458	218	100		
Prudential Borrowing	1,650	4,108	8,985	14,586	17,463
	<b>6,603</b>	<b>7,139</b>	<b>13,895</b>	<b>34,083</b>	<b>29,102</b>
<b>Total</b>	<b>36,330</b>	<b>37,698</b>	<b>37,798</b>	<b>39,110</b>	<b>33,673</b>
<b>HRA</b>					
Capital Receipts	18	28	38	40	41
Grants & Contributions	2,400	2,400	2,400	2,400	2,400
Revenue Contributions & Reserves	1,024	890	943	1,658	1,805
Supported Borrowing					
Prudential Borrowing	5,740	4,066	2,797	1,081	1,089
<b>Total</b>	<b>9,182</b>	<b>7,384</b>	<b>6,178</b>	<b>5,179</b>	<b>5,335</b>

#### 4 Ratio of Financing Costs to Net Revenue Stream

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. It shows how much of its budget the Council uses to repay debt and interest.

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4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2013/14 Approved £000	2013/14 Revised £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Financing Costs	12,168	12,669	13,002	13,958	14,399
Net Revenue Stream	190,687	191,573	187,683	185,882	185,882
<b>Council Fund Ratio</b>	<b>6.38%</b>	<b>6.61%</b>	<b>6.93%</b>	<b>7.51%</b>	<b>7.75%</b>
Financing Costs	3,092	2,973	3,249	3,385	3,390
Net Revenue Stream	12,662	12,727	13,260	13,882	14,575
<b>HRA Ratio</b>	<b>24.42%</b>	<b>23.36%</b>	<b>24.50%</b>	<b>24.38%</b>	<b>23.26%</b>

## 5 Capital Financing Requirement

5.1 The Capital Plan relies on various sources of finance i.e. grants, contributions and capital receipts. Once these are used up, we need to rely on borrowing and the Capital Financing Requirement (CFR) is the amount we need to borrow. Our borrowing shouldn't therefore go above the CFR. The Council's CFR and borrowing levels are compared in the table below for the current and future years.

Capital Financing Requirement	31/03/14 Approved £000	31/03/14 Revised £000	31/03/15 Estimate £000	31/03/16 Estimate £000	31/03/17 Estimate £000
Council Fund	150,707	145,486	161,803	171,967	184,174
HRA	33,375	30,669	31,705	30,889	30,031
PFI	10,526	10,526	10,437	10,058	9,627
<b>Total CFR</b>	<b>194,608</b>	<b>186,681</b>	<b>203,945</b>	<b>212,914</b>	<b>223,832</b>
<b>Total Debt</b>	<b>153,460</b>	<b>141,648</b>	<b>161,598</b>	<b>177,769</b>	<b>195,608</b>

Note that the projected debt level at 31/03/14 was originally estimated in February 2013 to be £12m higher than the revised estimate because the original estimate was based on the capital expenditure in the Capital Plan to be funded by borrowing for 2013/14. In practice, the Council has been internally borrowing as discussed earlier in the report and has not undertaken any external borrowing yet this year.

## 6 Incremental Impact of Capital Investment Decisions

6.1 This indicator shows how much of the Council Tax income is spent on paying debt interest.

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Incremental Impact of Capital Investment Decisions	2013/14 Approved £	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £
Increase in Band D Council Tax due to:				
Prudential Borrowing	5.35	3.47	2.63	2.63
Capital Receipts	0.69	0.00	0.00	0.00
Reserves	0.40	0.55	0.00	0.00
<b>Total</b>	<b>6.44</b>	<b>4.02</b>	<b>2.63</b>	<b>2.63</b>
Average Weekly Housing Rents	1.67	1.01	0.95	0.95

This indicator shows the equivalent impact on Council Tax of the decision to undertake Prudential Borrowing as well as the investment interest lost by using capital receipts and reserves to part fund the Capital Plan. The impact of supported borrowing has not been included because it is assumed that the Council would always spend its supported borrowing to fund its Capital Plan.

The increases in council house rents reflect the additional costs of financing the borrowing to be undertaken each year as part of the Housing Stock Business Plan with the aim to attain the Welsh Housing Quality Standard during 2014. The indicator illustrates the impact of each year's capital expenditure and new borrowing on weekly rents.

### 7 **Authorised Limit & Operational Boundary for External Debt**

- 7.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.
- 7.2 The **Authorised Limit** sets the maximum level of external borrowing. It is measured on a daily basis against all external borrowing items on the Balance Sheet i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices. This is reported as a part of the Capital Monitoring Report.
- 7.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.
- 7.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the

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Affordable Limit) and if it is breached, it would be reported to the next Council meeting.

Authorised Limit for External Debt	2013/14 Approved £000	2013/14 Revised £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Borrowing	175,000	165,000	220,000	240,000	260,000

Although details of the precise mechanism and timing are not available at this stage, the reform of the HRA subsidy system in Wales is likely to be implemented from 2015/16. Current calculations suggest that we will need to borrow £39m to buy ourselves out of the subsidy system and it is assumed that this will take place in March 2015. The borrowing limits shown above include an additional £40m from 2014/15 to cover this borrowing.

- 7.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Operational Boundary for External Debt	2013/14 Approved £000	2013/14 Revised £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000
Borrowing	170,000	160,000	215,000	235,000	255,000

### 8 Adoption of the CIPFA Treasury Management Code

- 8.1 This indicator demonstrates that the Council has adopted the principles of best practice. The Council adopted the original Code in March 2002. A revised Code was issued in November 2009 and another in November 2011. One of the recommendations is that the Code is adopted by Council.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the revised CIPFA Treasury Management Code (Nov 2011) at its meeting on 28 February 2012.

### 9 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- 9.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on a net interest paid basis (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments).
- 9.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact

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on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

	2013/14 Approved %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %
<b>Upper Limit for Fixed Interest Rate Exposure</b>	100	100	100	100
<b>Upper Limit for Variable Rate Exposure</b>	40	40	40	40

- 9.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

### 10 Maturity Structure of Fixed Rate borrowing

- 10.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.
- 10.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

<b>Maturity structure of fixed rate borrowing</b>	<b>Actual %</b>	<b>Lower Limit %</b>	<b>Upper Limit %</b>
under 12 months	3.63	0	10
12 months and within 24 months	1.58	0	10
24 months and within 5 years	4.99	0	20
5 years and within 10 years	5.87	0	25
10 years and above	83.93	50	100

### 11 Credit Risk

- 11.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.
- 11.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

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11.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

11.4 The only indicators with prescriptive values are credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

### 12 Upper Limit for total principal sums invested over 364 days

12.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2013/14 Approved £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
	6.00	10.00	10.00	10.00

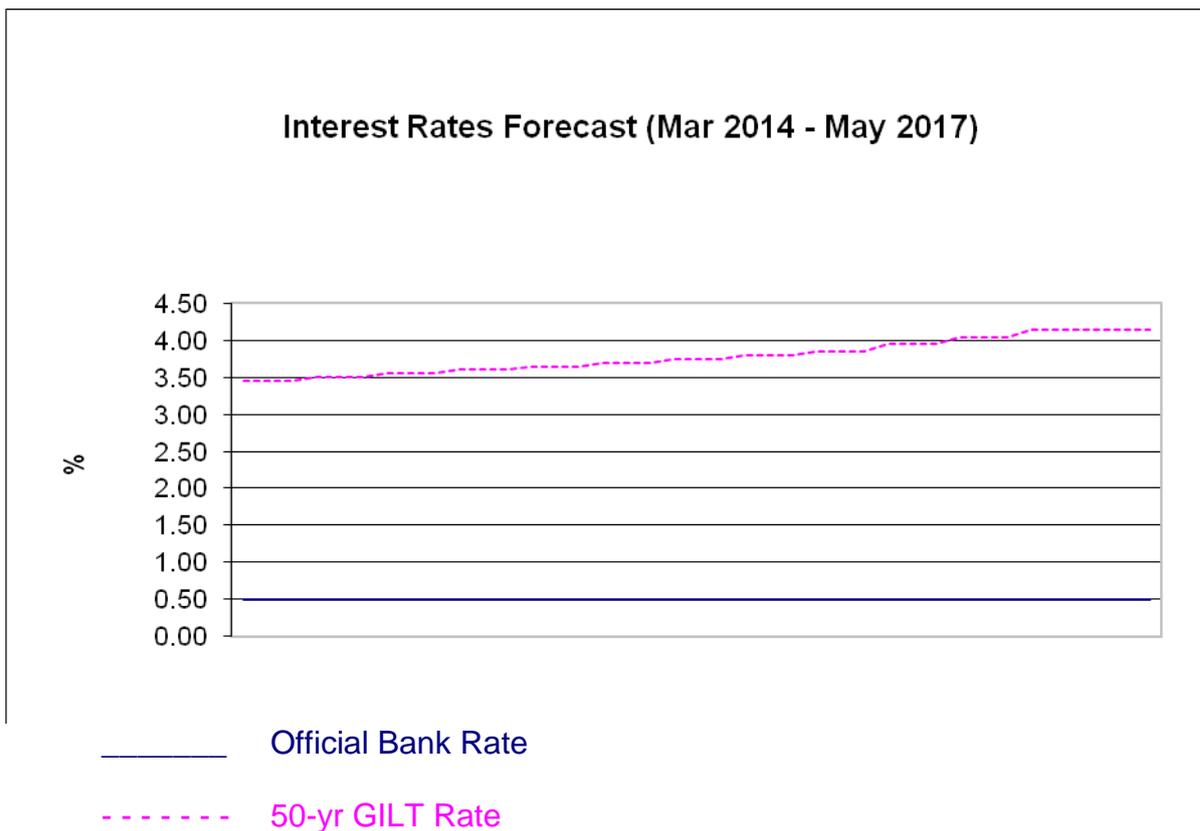
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## ANNEX B

### INTEREST RATES FORECAST

The graph below shows the interest rate forecast for the Official UK Bank Rate and the 50 year GILT rate from March 2014 to May 2017. The Official Bank Rate influences the rate at which the Council can invest. The GILT rate is the rate at which the Government borrows money and therefore this affects the rate at which we can borrow from the PWLB which is approximately 1% above GILT rates.

As the graph shows, it's much more expensive to borrow than to invest at the moment with the Official UK Bank Rate expected to remain at 0.5% for some time. The graph illustrates that the difference between investment and borrowing rates is approximately 3%. This means that the cost of carry referred to in paragraph 4.1 in **Appendix 1** is approximately £30,000 for every £1m borrowed because the Council could borrow for 50 years at a rate of approximately 4% but could only invest at a rate of approximately 1%.



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### GLOSSARY - Useful guide to Treasury Management Terms and Acronyms

Bank of England	UK's Central Bank
Bank Rate	Bank of England Interest Rate (also known as Base Rate)
CPI	Consumer Price Index – a measure of the increase in prices
RPI	Retail Price Index – a measure of the increase in prices
DMO	Debt Management Office – issuer of gilts on behalf of HM Treasury
FSA	Financial Services Authority - the UK financial watchdog
GDP	Gross Domestic Product – a measure of financial output of the UK
GILTS	Investments issued by UK Government which pay a fixed cash payment to the holder
LIBID	London Interbank Bid Rate - International rate that banks lend to other banks
LIBOR	London Interbank Offer Rate – International rate that banks borrow from other banks (the most widely used benchmark or reference for short term interest rates)
PWLB	Public Works Loan Board – a Government department that lends money to Public Sector Organisations
MPC	Monetary Policy Committee - the committee of the Bank of England that sets the Bank Rate
Long term rates	More than 12 months duration
Short term rates	Less than 12 months duration