APPENDIX 4

Herefordshire Council

Treasury Management Strategy 2014/15

Contents

Appendices

1. Background

1.1 The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) requires the council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. The TMSS also includes the Annual Investment Strategy as required under Investment Guidance provided by Communities and Local Government (CLG).

1.2 The council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the council's treasury management strategy.

1.3 The purpose of this TMSS is to approve:

- Treasury Management Strategy for 2014-15 (Borrowing – Section 3 and Investments – Section 4)
- MRP Statement – Section 5
- Prudential Indicators - Appendix 3

2. Capital Financing Requirement

2.1 Capital expenditure can be financed in a number of ways including the application of usable capital receipts, a direct charge to revenue, the application of a capital grant or by securing an up-front contribution from another party towards the cost of a project.

2.2 Capital expenditure not financed by one of the above methods will increase the capital financing requirement (CFR) of the council.

2.3 The CFR reflects the council's underlying need to finance capital expenditure by borrowing or by other long-term liability arrangements.

2.4 The use of the term "borrowing" in this context does not necessarily imply external debt since, in accordance with best practice, the council has an integrated treasury management strategy. Borrowing is not associated with specific capital expenditure. The council will, at any point in time, have a number of cash flows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy.

2.5 The forecast movement in the CFR over future years is one of the Prudential Indicators which can be found in Appendix 2. The movement in actual external debt and usable reserves (which have a direct bearing on when any internal borrowing may need to be externalised) combine to identify the council's borrowing requirement and potential investment strategy in the current and future years.

Table 1: Balance Sheet Summary Analysis

	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Capital Financing Requirement	218,276	264,038	289,809	298,547
Less: Other Long Term Liabilities:				
PFI schemes	26,853	25,707	24,489	23,208
Finance leases	320	320	320	320
Salix loan	341	208	74	0
CFR excluding other long-term liabilities	**190,762**	**237,803**	**264,926**	**275,019**
Less: Existing Profile of Longer Term Borrowing - PWLB and bank loans	136,535	132,523	124,285	117,243
Cumulative Maximum External Borrowing Requirement	**54,227**	**105,280**	**140,641**	**157,776**
Estimated Usable Reserves*	**23,323**	**19,613**	**38,935**	**58,435**
Cumulative Net Borrowing Requirement	**30,904**	**85,667**	**101,706**	**99,341**
***Usable Reserves includes fixed asset sales of £20 million in 2015/16 and £20 million in 2016/17**				
Total Council Borrowing	**167,439**	**218,190**	**225,991**	**216,584**

3. Borrowing

3.1 At 30th November 2013 the council had £138.4 million of longer term loans, £23 million of short-term loans and £33.6 million of investments. These are set out in further detail in *Appendix 1.*

3.2 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board
- UK local authorities
- Any institution approved for investments (see below)
- 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.

3.3 The council has two LOBO loans (Lender's Option Borrower's Option) of £6 million each on which the council pays interest at 4.5%. Every six months, when the interest charges become due, the lenders have the option to increase the interest rate being charged at which point the council can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the council since the decision to amend the terms is entirely at the lender's discretion.

3.4 The council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, by fully utilising usable reserves.

3.5 Given the significant cuts to public expenditure, and in particular to local government funding, the council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than longer-term rates, it is likely to be more cost effective in the short-term to use internal resources and to borrow short-term. By doing so, the council is able to reduce net borrowing costs and reduce overall treasury risk. Such a strategy is most likely to be beneficial over at least the next 2-3 years as official interest rates remain low.

3.6 The benefits of short-term borrowing are monitored regularly. Analysis comparing the cost of a longer term loan with short-term finance indicates that, with current and projected interest rates, the savings arising from short-term loans in the next three to five years outweigh any increased cost in later years. However, as and when short-term rates increase and the gap between short-term and longer-term finance reduces this decision will be reviewed. Arlingclose will assist the council in assessing the "cost of carry" and breakeven analysis.

3.7 The main reason for the significant increase in council borrowing is to fund the council's share of a new Energy from Waste Plant, a joint project with Worcestershire County Council. The incinerator is projected to cost Herefordshire Council up to £40 million over the three years from 2014/15 to 2016/17 inclusive.

3.8 In order to fund this and other necessary capital schemes the council proposes selling other fixed assets to raise proceeds of around £60 million (approximately £20 million per annum) over the three years from 2015/16 to 2017/18.

3.9 Appendix 2 shows total estimated council borrowing over the next twenty years, assuming that these proceeds are received.

3.10 Increased borrowing increases both interest payable and the amount to be set aside from revenue each year for the repayment of loan principal (called Minimum Revenue Provision (MRP)). Annual MRP is estimated to be around £10m. Therefore if, after the large capital schemes scheduled for the next few years are completed, the new capital spend financed by borrowing can be reduced to below the annual MRP the council's total borrowing will reduce, as shown in Appendix 2.

3.11 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Due to the prevailing low interest rate regime, opportunities for debt rescheduling are likely to be very limited. However, this option will be kept under review and the council may replace some loans with new loans, where this is expected to lead to an overall saving or reduction in risk.

4. Investments

4.1 The council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the financial year to date the council's investment balances have ranged between £9m and £59m. Sometimes balances have been high due to the council making term deposits and utilising cheaper short-term borrowing for liquidity purposes.

4.2 Interest rates on both term deposits and instant access accounts have fallen during the year. Because of this, and because of the increased credit risk due to new banking regulations (see 4.4 below), it is envisaged that investment balances during 2014/15 will be maintained at lower levels.

4.3 Both the CIPFA Code and the CLG Guidance require the council 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.

4.4 The credit risk of banking failures has diminished, but not dissipated altogether. Planned regulatory changes in the UK, US and Europe will see a move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

4.5 The council may invest its surplus funds with any of the counterparties in Table 2 below, subject to the limits shown.

Table 2: Approved Investment Counterparties			
Counterparty		**Investment limit**	**Time limit †**
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	Higher of £5m and 15% of total investments	10 years*
	AA+		5 years*
	AA		4 years*
	AA-		3 years*
	A+		2 years
	A		1 year
	A-		
The council's current account bank (Nat West) if it fails to meet the above criteria			next day
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£10m each	50 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		Higher of £5m and 15%	10 years**
UK Registered Providers of Social Housing without published long-term credit ratings		£2m each	5 years
UK Building Societies without credit ratings		£2m each	1 year
Money market funds and other pooled funds		Higher of £5m and 15%	n/a
Any other organisation, subject to an external credit assessment and specific advice from the council's treasury management adviser		£2m each	3 months
		£1m each	1 year
		£100k each	5 years

† the time limit is doubled for investments that are secured on the borrower's assets
* but no longer than 2 years in fixed-term deposits and other illiquid instruments
** but no longer than 5 years in fixed-term deposits and other illiquid instruments

4.6 For institutions within a banking group, a limit of 1.5 times the individual limit of a single bank within that group is used. For example, a single bank may have a limit of 15% but if it is part of a group an overall group limit of 22.5% will be applied.

4.7 Credit conditions will be monitored during the year and, if credit conditions deteriorate, the above limits will be reviewed and may be reduced.

4.8 Investments will not be restricted to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

4.9 In addition, the council may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the council's treasury management adviser.

4.10 **Current Account Bank**: Should the credit ratings fall below A-, the council may continue to deposit surplus cash in instant access accounts with Nat West provided that the bank maintains a credit rating no lower than BBB- (the lowest investment grade rating).

4.11 **Registered Providers**: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving government support if needed. The council will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

4.12 **Building Societies**: The council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the council's deposits would be paid out in preference to retail depositors. The council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

4.13 **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the council. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

4.14 **Other Organisations:** The council may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the council's treasury management adviser.

4.15 **Risk Assessment and Credit Ratings**: The council 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 council'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.

4.16 Where a credit rating agency announces that a A- rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.17 **Other Information on the Security of Investments**: The council 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, 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.

4.18 **Specified Investments**: The CLG 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 council defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or in a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is also defined as those having a credit rating of A- or higher.

4.19 **Non-specified Investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. 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, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits	
	Cash limit
Total long-term investments	£10m
Total investments without credit ratings or rated below A- (including unrated building societies)	£15m

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

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the council may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £5 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

4.21 **Policy on Use of Financial Derivatives**

The CIPFA Code requires councils to clearly detail their policy on the use of derivatives in the annual strategy. Derivatives are instruments which are used to mitigate interest rate risk. The council will only consider the use of standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the council is exposed to. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria.

5. 2014/15 Minimum Revenue Provision Statement

5.1 The council is required to set an annual policy on the way it calculates the prudent provision for the repayment of borrowing. The charge to the Revenue Account is referred to as the Minimum Revenue Provision.

5.2 CLG's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

5.3 The broad aim of the policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure (which gave rise to the debt) provides benefits.

Options for making 'Prudent Provision'

5.4 There are four options for Prudent Provision set out in the guidance:

Option 1 - Regulatory

For debt which is supported by the Government through Revenue Support Grant (RSG), authorities may continue to use the formulae under the 2003 Regulations, as

RSG debt support is calculated in that way. This includes applying an adjustment (the Item A adjustment), which reduces the charge back to the former credit ceiling accounting methodology.

Option 2 - CFR method

This is similar to option 1, but just uses the CFR and doesn't apply the full formula, including the Item A adjustment. Under this option the annual repayment would be higher.

Option 3 - Asset Life method

For new borrowing under the prudential system there are 2 options in the guidance. The first is to make provision over the estimated life of the asset for which the borrowing is undertaken. This can either be on an equal instalment method or an annuity basis.

Option 4 - Depreciation method

An alternative to Option 3 is to make provision in line with depreciation accounting. Although this would follow standard rules for depreciation accounting there would have to be some exceptions, for example, that MRP would continue until the provision is equal to the original debt and then cease.

MRP Policy 2014/15

5.5 In line with the guidance produced by the Secretary of State, the proposed policy for the 2014/15 calculation of MRP (unchanged from previous years) is as follows:

- Borrowing supported through the RSG grant system will be repaid in accordance with the 2003 Regulations.
- Prudential borrowing will be repaid over the life of the asset on an equal instalment basis commencing in the year following the year in which the asset first becomes operational.
- For expenditure under Regulation 25(1)(b), loans and grants towards capital expenditure by third parties, prudential borrowing will be repaid over the life of the asset in relation to which the third party expenditure is incurred.
- MRP in respect of PFI and leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

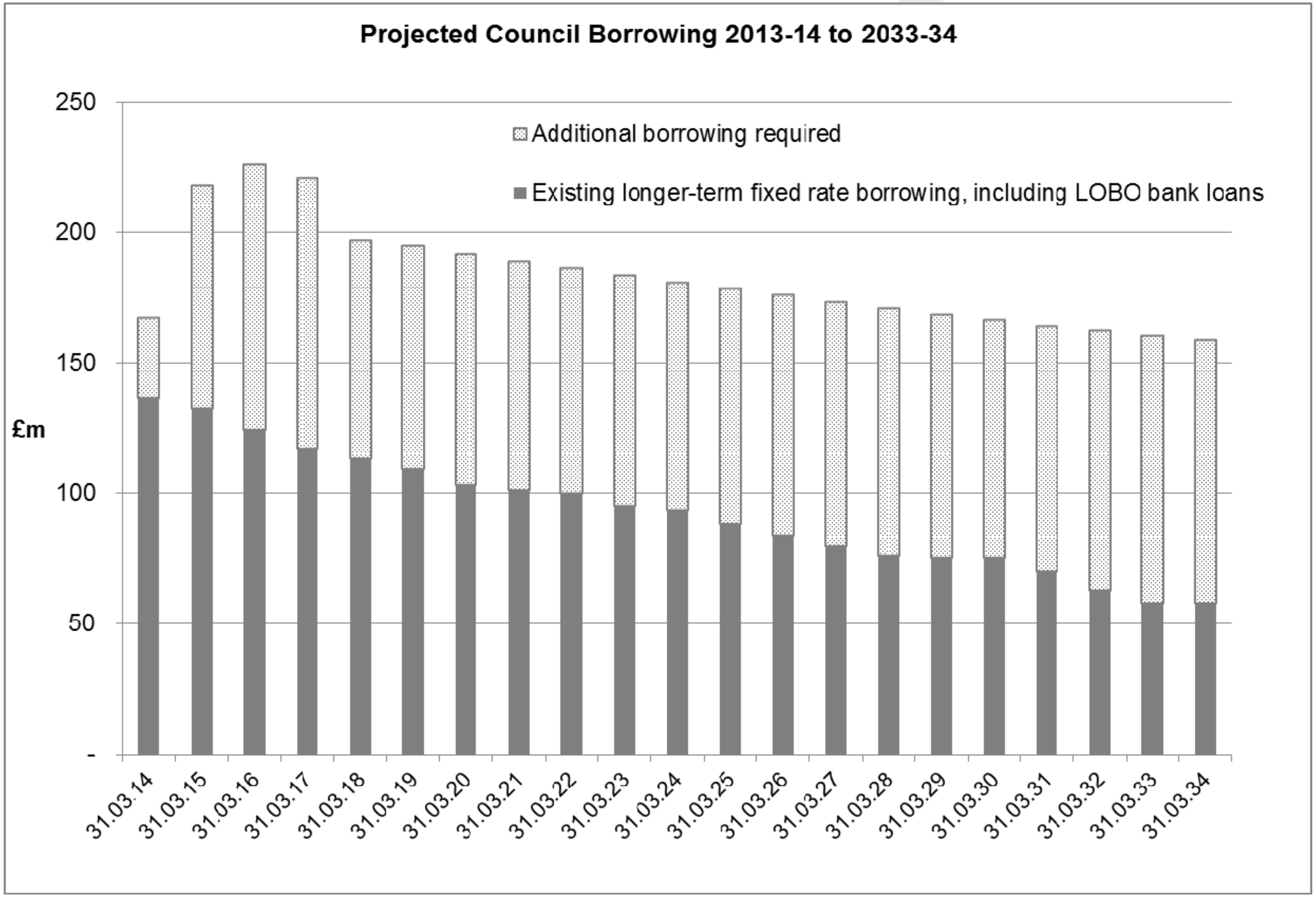
APPENDIX 1

EXISTING BORROWING & INVESTMENTS AS AT 30 NOVEMBER 2013

External Borrowing:	**Actual Portfolio** **£m**	**Average Rate** **%**
PWLB – Fixed Rate	**126**	**4.01%**
PWLB – Variable Rate	**0**	
Local Authorities	**23**	**0.40%**
LOBO Loans	**12**	**4.50%**
Total External Borrowing	**161**	**3.53%**

Investments:	**Actual Portfolio** **£m**	**Average Rate** **%**
Investments: **(All short-term (one year or less) and all managed in house)**		
Nat West & Royal Bank of Scotland Instant Access Accounts	**10**	**0.60%**
Money Market Funds (Instant Access)	**9**	**0.43%**
Close Brothers One Month Notice Account	**5**	**1.00%**
Term deposits: UK Banks	**10**	**0.75%**
Total Investments	**34**	**0.66%**

APPENDIX 2



Projected Council Borrowing 2013-14 to 2033-34
Additional borrowing required
Existing longer-term fixed rate borrowing, including LOBO bank loans
£m
250
200
150
100
50
-
31.03.14
31.03.15
31.03.16
31.03.17
31.03.18
31.03.19
31.03.20
31.03.21
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APPENDIX 3

PRUDENTIAL INDICATORS

1. Background

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 local authority 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 capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

The Chief Finance Officer reports that the council had no difficulty meeting this requirement in 2013/14, nor are there any difficulties envisaged for 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 levels.

Capital Expenditure	2013/14 Approved £'000	2013/14 Revised £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Total	**58,076**	**51,176**	**85,351**	**39,909**	**21,436**

3.2 Capital expenditure will be financed as follows:

	2013/14 Approved £'000	2013/14 Revised £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Capital receipts	1,569	3,271	3,209	1,904	0
Grants	26,487	31,005	24,905	634	666
Revenue contributions	0	61	0	0	0
Prudential Borrowing	30,020	16,839	57,237	37,371	20,770
Total	**58,076**	**51,176**	**85,351**	**39,909**	**21,436**

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 financing costs. The definition of financing costs is set out in the Prudential Code and includes both interest payable and provision for repayment of loan principal..

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
Net Revenue Stream	150,296	150,296	**146,456**	141,318	140,474
Financing Costs	17,725	17,343	**18,288**	18,781	19,230
Percentage	**11.79%**	**11.54%**	**12.49%**	**13.29%**	**13.69%**

Note: the net revenue stream comprises council tax receipts plus government funding excluding specific grants.

4.3 The above table shows gross financing costs payable without deducting any savings or revenue contributions receivable. Financing costs also include the capital element of PFI contracts, Whitecross School, waste disposal and Shaw Homes.

5. Capital Financing Requirement

5.1 The Capital Financing Requirement (CFR) measures the council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing. The table below includes PFI contracts.

Capital Financing Requirement	2013/14 Approved £'000	2013/14 Revised £'000	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000
Total CFR	**230,952**	**218,276**	**264,038**	**289,809**	**298,547**

6. Incremental Impact of Capital Investment Decisions

6.1 This is an indicator of affordability that shows the impact of capital investment decisions on council tax levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme including new additional capital schemes.

6.2 All the new additional capital schemes are self-financing in 2014/15 to 2016/17 with all costs covered by additional revenue received. Therefore there should be no increase in Band D council tax in these years arising from new additions to the capital programme.

7. Authorised Limit and 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.

6.2 The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the council. It is measured on a daily basis against all external debt 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.

6.3 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 Affordable Limit).

Authorised Limit	2013/14 Approved £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Authorised Limit for Borrowing	200	200	250	280	290
Authorised Limit for other Long-Term Liabilities	40	40	40	40	40
Authorised Limit for External Debt	**240**	**240**	**290**	**320**	**330**

6.4 The Operational Boundary has been set on the estimate of the most likely, i.e. prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

6.5 The Operational Boundary links directly to the council's estimates of the CFR and estimates of other cashflow 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	2013/14 Approved £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Operational Boundary for Borrowing	195	195	240	270	280
Operational Boundary for other Long-Term Liabilities	35	35	30	30	30
Operational Boundary for External Debt	**230**	**230**	**270**	**300**	**310**

7. Adoption of the CIPFA Treasury Management Code

7.1 This indicator demonstrates that the council has adopted the principles of best practice.

7.2 The council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices. The council's Treasury Management Policy Statement is attached at **Appendix 5**.

8. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

8.1 These indicators allow the council to manage the extent to which it is exposed to changes in interest rates.

8.2 Due to the large difference between short-term and longer-term interest rates, the limit has been increased to accommodate the council financing the capital programme by short-term variable rate borrowing. Interest rates are forecast to remain low for the next few years and analysis (comparing a twenty year loan with short-term borrowing over the same period) indicates that short-term savings in the next few years will exceed any increased amounts payable in five to ten years time. In pursuing this policy the council recognises that it is more exposed to an unexpected hike in interest rates but the benefits of affordability and flexibility (enabling the council to reduce its short-term borrowing either to reduce cash investments at times of heightened credit risk or when the borrowing can be replaced by the proceeds from fixed asset sales) outweigh the increased interest rate risk.

	2013/14 Approved	**2013/14 Revised**	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**
Upper Limit for Fixed Interest Rate Exposure	100%	100%	**100%**	100%	100%
Upper Limit for Variable Interest Rate Exposure	25%	25%	**45%**	45%	45%

9. Maturity Structure of Fixed Rate Borrowing

9.1 The council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to control excessive exposures to volatility in interest rates when refinancing maturing debt.

9.2 The maturity of borrowing is determined by reference to the earliest date on which the loans could be repaid. Therefore the council's two LOBO loans are included as being repayable within 12 months although, if the lenders do not increase the interest rates being charged, the loans could remain outstanding until 2054.

Maturity structure of fixed rate borrowing	Estimated level at 31/03/14	Lower Limit for 2014/15	Upper Limit for 2014/15
Under 12 months (including £12m of LOBO loans)	11.73%	0%	30%
12 months and within 24 months	6.03%	0%	30%
24 months and within 5 years	11.11%	0%	30%
5 years and within 10 years	11.22%	0%	30%
10 years and within 20 years	26.22%	0%	40%
20 years and within 30 years	10.25%	0%	40%
30 years and within 40 years	10.99%	0%	40%
40 years and within 50 years	12.45%	0%	40%
Total	100%		

10. Upper Limit for total principal sums invested over 364 days:

10.1 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	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
	15	**15**	**10**	**10**	**10**

APPENDIX 4

OUTLOOK FOR INTEREST RATES
(FORECAST & ECONOMIC COMMENT PROVIDED BY ARLINGCLOSE)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Bank Base Rate (%)	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
PWLB Rates (%):													
5 years	**2.45**	**2.50**	**2.55**	**2.60**	**2.65**	**2.70**	**2.75**	**2.85**	**2.95**	**3.10**	**3.30**	**3.50**	**3.50**
10 years	**3.55**	**3.60**	**3.65**	**3.70**	**3.75**	**3.80**	**3.85**	**3.90**	**4.00**	**4.10**	**4.30**	**4.50**	**4.50**
20 years	**4.25**	**4.30**	**4.35**	**4.40**	**4.45**	**4.50**	**4.55**	**4.65**	**4.75**	**4.85**	**5.05**	**5.15**	**5.15**
50 years	**4.45**	**4.50**	**4.55**	**4.60**	**4.65**	**4.70**	**4.75**	**4.80**	**4.85**	**4.95**	**5.05**	**5.15**	**5.15**
The above PWLB rates are noted by Arlingclose as their “central” or most likely forecast, however, they also note that they could be up to 1.00% higher or up to 0.80% lower than the above (with the margin for error increasing in the later years) .													

Underlying assumptions:

- Growth continues to strengthen with the second estimate for the third quarter being an unrevised 0.8%. The service sector remains the main driver of growth, boosted by a contribution from construction.
- The CPI for November fell to 2.1%. Utility price increases are expected to keep CPI above the 2% target in 2014, before falling back again.
- The principal measure in the MPC’s Forward Guidance on interest rates is the Labour Force Survey (LFS) unemployment rate. The MPC intends not to raise the Bank Rate from its current level of 0.5% at least until this rate has fallen to a threshold of 7%.

- The reduction in uncertainty and easing of credit conditions have begun to unlock demand, much of which has fed through to the housing market. In response to concerns over a house price bubble, the Bank of England announced a curtailment of the Funding for Lending Scheme, which will henceforth concentrate on business lending only.
- Federal Reserve monetary policy expectations - the slowing in the pace of asset purchases ('tapering') and the end of further asset purchases - will remain predominant drivers of the financial markets. Tapering of asset purchases will begin in the first quarter of 2014. The US political deadlock over the debt ceiling will also need resolving in the first quarter.
- The European backstop mechanisms have lowered the risks of catastrophic meltdown. The slightly more stable economic environment could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over longevity of their coalitions).
- China data has seen an improvement, easing markets fears. Chinese leaders have signalled possible monetary policy tightening.

Forecast:

- Our projected path for short term interest rates remains flat. Markets are still pricing in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. The MPC will not raise rates until there is a sustained period of strong growth. However, upside risks weight more heavily at the end of our forecast horizon.
- We continue to project gilt yields on an upward path through the medium term. The recent climb in yields was overdone given the global outlook and risks surrounding the Eurozone, China and US.

APPENDIX 5

TREASURY MANAGEMENT POLICY STATEMENT

1. Statement of Purpose

1.1 Herefordshire council adopts the recommendations made in CIPFA's *Treasury Management in the Public Services: Code of Practice,* which was revised in 2011. In particular, the council adopts the following key principles and clauses.

2. Key Principles

2.1 Herefordshire council adopts the following three key principles (identified in Section 4 of the Code):

- The council will put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of its treasury management activities.

- The council will ensure that its policies and practices make clear that the effective management and control of risk are prime objectives of its treasury management activities and that responsibility for these lies clearly with the council. In addition, the council's appetite for risk will form part of its annual strategy and will ensure that priority is given to security and liquidity when investing funds.

- The council acknowledges that the pursuit of best value in treasury management, and the use of suitable performance measures, are valid and important tools to employ in support of business and service objectives, whilst recognising that in balancing risk against return, the council is more concerned to avoid risks than to maximise returns.

3. Adopted Clauses

3.1 Herefordshire council formally adopts the following clauses (identified in Section 5 of the code):

- The council will create and maintain, as the cornerstones for effective treasury management:

  - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;

  - Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

  The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the council. Such amendments will not result in the organisation materially deviating from the Code's key principles.

- Full council will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

- The responsibility for the implementation and regular monitoring of treasury management policies and practices is delegated to Cabinet and for the execution and administration of treasury management decisions to the Chief Officer-Finance and Commercial, who will act in accordance with the organisation's policy statement and TMPs and, if he or she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

- Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

4. Definition of Treasury Management

4.1 Herefordshire council defines its treasury management activities as: -

'The management of the organisation'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.'

5. Policy Objectives

5.1 Herefordshire council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the council, and any financial instruments entered into to manage these risks.

5.2 Herefordshire council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.