

Title of meeting: Governance and Audit and Standards Committee
Cabinet
City Council

Date of meeting: Governance and Audit and Standards Committee 16
September 2016
Cabinet 22 September 2016
City Council 11 October 2016

Subject: Treasury Management Mid-Year Review 2016/17

Report by: Director of Finance and Information Services (Section 151
Officer)

Wards affected: All

Key decision: Yes

Full Council decision: Yes

1. Purpose of report

The purpose of the report is to review the current treasury management position and strategy and make recommendations to improve the strength and performance of the treasury management operation. This report seeks to further diversify the Council's investment portfolio by increasing the number of countries that the Council can invest in and by allowing investments with a BBB credit rating. Appendix A aims to inform members and the wider community of the Council's current Treasury Management position and of the risks attached to that position.

2. Recommendations

1. That the operational boundary be increased by £50m from £549.5m to £599.5m
2. That the geographic investment limits applied to regions outside the United Kingdom be increased as follows:

Region	Current Limits	Recommended Revised Limits
Asia & Australia	£60m	£80m
Americas	£60m	£80m
Eurozone	£30m	£60m
Continental Europe outside the Eurozone	£30m	£60m

3. That the limits placed on total sums invested for periods longer than 364 is increased as follows:

Sums invested beyond:	Current Limits	Recommended Revised Limits
31/3/2017	£196m	£288m
31/3/2018	£123m	£199m
31/3/2019	£90m	£90m

4. That investments should only be placed with institutions based in either the United Kingdom or sovereign states with at least an AA credit rating (the current strategy requires at least an AA+ credit rating)
5. It is recommended that investments be permitted in counter parties that do not meet the Council's credit criteria if the investment is secured against assets that do meet the Council's investment criteria
6. That investments in counter parties with long term credit ratings of BBB+ / Baa1 and short term credit ratings of F2 / P-3 / A3 be permitted for periods up to 364 days with an individual counter party limit of £7m
7. That up to £8m is invested in corporate bond funds where the underlying investments have an average credit rating of at least BBB+ but may include lower rated investment grade holdings
8. That up to £10m be invested in bonds issued by Hampshire Community Bank providing the bonds can be secured against good quality assets owned by the Bank

9. That the following actual Treasury Management indicators for July 2016 be noted:

(a) The Council's debt at 31 July was as follows:

	Original Prudential Indicator	Revised Prudential Indicator Under Standing Order 58	Recommended Prudential Indicator	Position at 31/7/16
Authorised Limit	£567.8m	£617.8m	£617.8m	£582.4m
Operational Boundary	£549.5m	£549.5m	£599.5m	£582.4m

(b) The maturity structure of the Council's borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	10%	10%	10%	20%	30%	30%	30%	40%
Actual	1%	1%	4%	7%	22%	12%	18%	35%

(c) Sums invested for periods longer than 364 days at 31 July 2016 were:

Maturing after	Limit	Actual
	£m	£m
31/3/2017	196	168
31/3/2018	123	90
31/3/2019	90	25

(d) The Council's interest rate exposures at 31 July 2016 were:

	Limit	Actual
	£m	£m
Fixed Interest	358	289
Variable Interest (Net Investments)	(444)	(288)

3. Background

CIPFA's Treasury Management Code requires a Treasury Management Mid-Year Review to be considered by the City Council. The Council's treasury management position at 31 July and the risks attached to that position are reported in Appendix A.

Following the referendum result to leave the EU there was a sharp fall in Public Works Loans Board (PWLB) rates as investors anticipated that there would be further quantitative easing in the form of purchases of gilts in the coming months. In order to take advantage of the low rates on offer the Chief Executive made an urgent decision under Standing Order 58 to increase the authorised limit for external debt by £50m from £567.8m to £617.8m.

The Council's investment portfolio has increased by 35% in 2016/17 from £371.8m on 1 April to £500.7m as at 31 July largely due to borrowing £94m to take advantage of low interest rates. Consequently the Council has invested up to its geographical limits in Europe. Despite this there have only been limited opportunities to place investments with counter parties based in Asia, Australia and the Americas. The geographic counter party limits for these regions have yet to be fully utilised.

Investment rates have fallen since the referendum decision to leave the EU. The optimal investment period is now 2 years with investment rates now being around 0.65% for 1 year, 0.85% for 2 years and 0.90% for 5 years.

Following the result of the referendum on EU membership, the sovereign credit ratings of the UK Government have been cut as follows:

Agency	Pre Referendum Credit Rating	Current Post Referendum Credit Rating
Fitch	AA+	AA
Moody's	AA+	AA+
Standard and Poor's	AAA	AA

One of the lending objectives of the Treasury Management Strategy is to make funds available for the regeneration of Hampshire. Hampshire Community Bank is seeking to raise £5m to £10m through a corporate bond issue. The bond would offer up to 3.5% interest and would enable the bank to lend to small and medium sized entities at rates from 5.5%.

4. Reasons for Recommendations

The authorised limit for external debt is the maximum amount of debt which the authority may legally have outstanding at any time. The Authorised Limit includes headroom to enable the Council to take advantage of unexpected movements in interest rates and to accommodate any short-term debt or unusual cash movements that could arise during the year. In addition to the authorised limit, the Council also sets an operational boundary. The Operational Boundary is based on the probable external debt during the course of the year. It is not a limit, but acts as a warning mechanism to prevent the authorised limit being breached. The Council's external debt on 5 July 2016 after the Council last undertook long term borrowing was £582.4m which exceeds the current operational boundary of £549.5m. It is recommended that the operational boundary be increased by £50m from £549.5m to £599.5m in line with the increase in the authorised limit so that the operational boundary can continue to act as a warning mechanism.

In order to ensure that the Council's exposure to regions outside the United Kingdom can be maintained on a proportionate basis it is recommended that the geographic investment limits be increased. It is recommended that the geographic investment limits for Asia and Australia, and the Americas be increased in line with the overall increase in the investment portfolio from £60m to £80m each. It is recommended that the geographic limits for the Eurozone and continental Europe outside the Eurozone be increased by a greater amount from £30m to £60m each to compensate for the difficulties experienced in placing investments with counter parties based in Asia, Australia and the Americas

It is recommended that the limits for sums invested for over 364 days be increased as follows to take account of the current cash flow forecast and facilitate investing for the optimal period of two years.

Sums invested beyond:	Current Limits	Recommended Revised Limits
31/3/2017	£196m	£288m
31/3/2018	£123m	£199m
31/3/2019	£90m	£90m

Sovereign credit ratings are driven by the ability of countries to collect tax to repay their debts. This is largely a reflection of the strength of a country's economy. For many years the Council has had an implied policy of only investing in institutions that are based in countries that have at least as strong a credit rating as the UK, ie. with economic prospects that are at least as good as the UK's. Now that two of the three main credit rating agencies rate the UK as AA it would be appropriate to include institutions based in other countries with an AA credit rating as approved investments. This would allow the Council to invest in banks and commercial companies based in Belgium, France and Qatar including BNP Paribas, Credit Agricole, Credit Industriel et Commercial and Societe Generale in France, and Qatar National Bank. Increasing the number of available investment counter parties will increase diversification and increase the opportunities to earn good rates of interest.

There are a number of other recommendations that should increase diversification and increase the opportunities to earn good rates of interest.

Investing in counter parties that do not meet the Council's credit criteria if the investment is secured against assets that do meet the Council's investment criteria will increase the number of counter parties the Council can invest in and may increase investment returns. Although this will increase the risk of defaults, it should not increase the risk of investment losses provided that the contracts are properly drawn up and the assets offered as security pass to the Council.

Investing up to 364 days in investments with a long term credit rating of BBB+ / Baa1 and a short term credit rating of at least F2 / P-3 / A3 would diversify the portfolio by enabling investments to be made in more commercial companies such as British Telecom. The risk of an investment defaulting is driven by the credit quality of the investment counter party and the duration of the investment, ie. the amount of time that credit quality can deteriorate over. An investment counter party rated BBB+ is more likely to default than an investment counter party rated A-. However an 18 month investment is more likely to default than a 12 month investment. Therefore a 12 month investment rated BBB+ can offer a lower probability of default than an 18 month investment rated A-. Therefore investing up to 364 days in investments rated BBB+ would diversify the portfolio by enabling investments to be made in more commercial companies without increasing the risk of default. Such investments could also achieve investment returns in excess of 0.9%.

Further diversification could be achieved by investment in a corporate bond fund. Investing in a corporate bond fund where the average credit rating of the underlying investments is BBB+ could yield 1.92% after fees. Such funds could include underlying investments with BBB- credit ratings although each investment would amount to no more than 4% of the fund. If one of the underlying investments did default the Council's holding in the fund could be worth less than what it paid into the fund, ie. the Council could make a loss. It is therefore recommended that total investments in such funds be restricted to £8m.

Purchasing a bond in Hampshire Community Bank (HCB) would contribute to the regeneration of Hampshire and offer interest of up to 3.5%. Investing in HCB would carry greater risk than the other approved investments contained in the Council's Annual Investment Strategy as HCB is a new entity that is in the process of developing its business, and currently has neither a banking license nor a credit rating. However HCB may be able to offer assets as security to cover a corporate bond. These assets would consist of good performing loans secured against tangible assets. The loan assets offered as security would pass to the Council in the event of HCB defaulting. It is recommended that investments in HCB of up to £10m be permitted provided that HCB can offer adequate security.

5. Equality impact assessment (EIA)

The contents of this report do not have any relevant equalities impact and therefore an equalities impact assessment is not required.

6. Legal Implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2015 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

7. Director of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Financial Services & IS (Section 151 Officer)

Appendices:

Appendix A: Treasury Management Mid-Year Review 2016/17

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

<u>Title of document</u>	Location
1 Information pertaining to treasury management strategy and performance	Financial Services
2	

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by the Cabinet on 22 September 2016.

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Signed by: Leader of the Council

TREASURY MANAGEMENT MID YEAR REVIEW OF 2016/17

1. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 22 March 2016 provide the framework within which Treasury Management activities are undertaken.

2. ECONOMIC UPDATE

UK gross domestic product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country. However, the 2015 growth rate finally came in at a disappointing 1.8% so this shows that growth had slowed down, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to +0.7% but fell back again to +0.4% (2.0% y/y) in quarter 1 of 2016. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme and uncertainty created by the Brexit referendum.

Following the Brexit referendum a new Prime Minister was appointed and there was a major Cabinet reshuffle including the appointment of a new Chancellor. The new Chancellor has said he will do "whatever is needed" to promote growth. The Chancellor could seek to promote growth through fiscal policy, for example cutting taxes and increasing investment allowances for business, and / or increasing government expenditure on infrastructure and housing etc.

On 4 August the Bank of England (BoE) announced the following measures:

- Cut the base rate from 0.50% to 0.25%
- New gilt purchases of £60bn
- High quality corporate bond purchases of £10bn
- Term Funding Scheme to provide £100bn of cheap funding to banks

The last three measures will boost the amount of quantitative easing from £375bn to £545bn.

The Bank of England Governor, Mark Carney, has provided forward guidance that there could be a further cut in the base rate to near zero, if data comes in as forecast. Mark Carney has dismissed ideas of negative interest rates and helicopter money.

The August Inflation Report which was released at the same time showed the BoE left its growth forecasts unchanged at 2% for 2016 as the economy expanded faster in the first half of 2016 than it had expected in May. The forecast for 2017 has been revised down significantly to 0.8% from a previous estimate of 2.3%.

Forecast for inflation was revised up sharply as a result of a big drop in sterling since the EU referendum result, with inflation forecast to rise above the MPC's 2% target in 2018 to about 2.3%.

A number of geopolitical risks are arising including:

- Under capitalisation of Italian banks poses a major risk with state aid firmly ruled out by the EU as a potential way out
- October 2016 Italian constitutional referendum on reforming the Senate and reducing its powers has also become a confidence vote on Prime Minister Renzi who has said he will resign if there is a 'no' vote; this could destabilise Italy and stop progress to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth
- Nov 2016 US presidential election
- 2017: French Presidential election April – May and German Federal general election between August and October could be affected by significant shifts in voter intentions as a result of terrorist attacks and a rise in anti EU sentiment
- Core EU principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states

The US economy is growing strongly. The next rate rise is now likely to be postponed until December 2016. Then sharper increases will cause Treasury yields to also rise. This should give rise to a growing gap between Treasury and gilt yields over time.

There is lack lustre economic growth in the EU (our biggest trading partner), which could be negatively impacted by political developments.

Japan is bogged down in anaemic growth and making little progress on fundamental reform of the economy

Chinese economic growth is weakening.

3. INTEREST RATE FORECAST

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

Apart from the uncertainties already explained above, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Federal Reserve rate increases, causing a further flight to safe havens (bonds).
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than currently anticipated.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Federal Reserve funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Now	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19	Jun 19
Base Rate	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.50
3 month LIBID	0.29	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.40	0.50	0.60
6 month LIBID	0.40	0.30	0.30	0.30	0.40	0.40	0.50	0.50	0.50	0.60	0.60	0.70
12 month LIBID	0.61	0.50	0.50	0.60	0.60	0.70	0.70	0.70	0.80	0.80	0.80	0.90
5 year PWLB	1.01	1.00	1.00	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.30
10 year PWLB	1.54	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80
25 year PWLB	2.33	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60
50 year PWLB	2.10	2.10	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.40

4. NET DEBT

The Council's net borrowing position excluding accrued interest at 31 July 2016 was as follows:

	1 April 2016	31 July 2016
	£'000	£'000
Borrowing	406,120	499,278
Finance Leases	2,149	1,869
Service Concession Arrangements (including Private Finance Initiative)	82,109	81,285
Gross Debt	490,378	582,432
Investments	(371,827)	(500,682)
Net Debt	118,551	81,750

The Council has a high level of investments relative to its gross debt due to a high level of reserves, partly built up to meet future commitments under the Private Finance Initiative schemes and future capital expenditure. However these reserves are fully committed and are not available to fund new expenditure. £84m of borrowing taken in 2011/12 and £94m of new borrowing taken in 2016/17 to take advantage of the very low PWLB rates has also temporarily increased the Council's cash balances.

The current high level of investments increases the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period where investments are high because loans have been taken in advance of need, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested. The level of investments will fall as capital expenditure is incurred and commitments under the Private Finance Initiative (PFI) schemes are met.

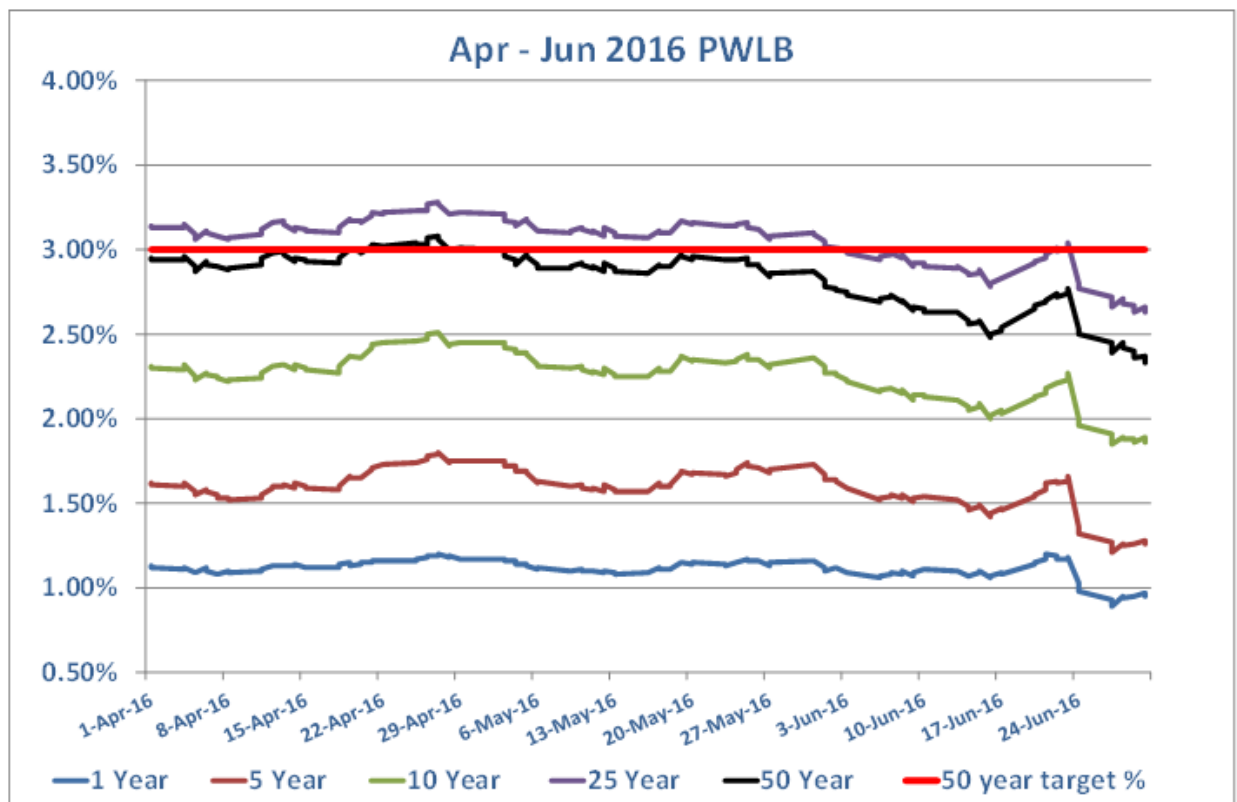
5. DEBT RESCHEDULING

Under certain circumstances it could be beneficial to use the Council's investments to repay its debt. However this normally entails paying a premium to the lender, namely the Public Works Loans Board (PWLB). Debt rescheduling is only beneficial to the revenue account when the benefits of reduced net interest payments exceed the cost of any premiums payable to the lender. Debt rescheduling opportunities have been limited in the current economic climate and by the structure of interest rates following increases in PWLB new borrowing rates in October 2010.

No debt rescheduling was undertaken in 2016/17.

6. BORROWING ACTIVITY

The graph below shows the PWLB's certainty rates in the first quarter of 2015/16.



There were many small movements in PWLB rates in the first three months of 2015/16, both upwards and downwards, but overall the general trend has been an increase in interest rates during April but then a fall during the rest of the quarter. PWLB rates were below the target rates for new borrowing supplied by Capita for most of the quarter.

The Council took three loans from the PWLB repayable in equal instalments over 25 years prior to the EU referendum as follows:

- £25m on 11 May at 2.57%
- £30m on 8 June at 2.42%
- £9m on 17 June at 2.34%

Following the referendum result to leave the EU there was a sharp fall in Public Works Loans Board (PWLB) rates as investors anticipated that there would be further quantitative easing in the form of purchases of gilts in the coming months. In order to take advantage of the low rates on offer the Chief Executive made an urgent decision under Standing Order 58 to increase the authorized limit for external debt by £50m from £567.8m to £617.8m. This enabled the Council to borrow £25m at 2.24% on 28 June and £5m at 1.97% on 5 July. Both loans are repayable in equal instalments over 25 years.

The Council's debt at 31 July was as follows:

	Original Prudential Indicator	Revised Prudential Indicator Under Standing Order 58	Recommended Prudential Indicator	Position at 31/7/16
Authorised Limit	£567.8m	£617.8m	£617.8m	£582.4m
Operational Boundary	£549.5m	£549.5m	£599.5m	£582.4m

7. MATURITY STRUCTURE OF BORROWING

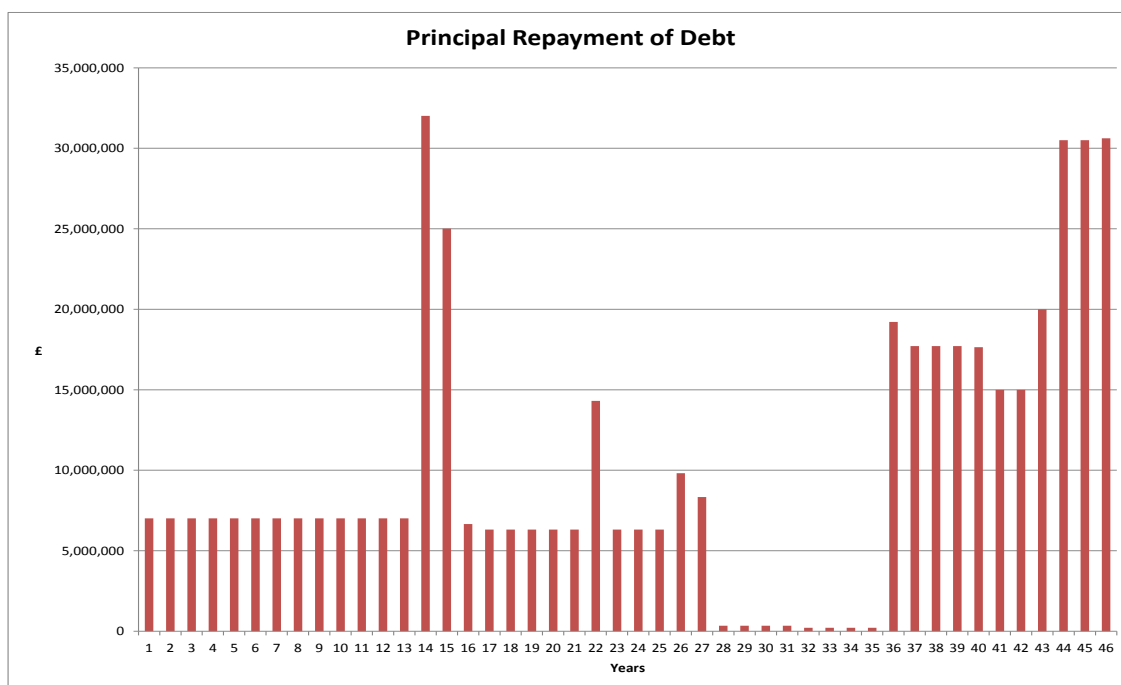
In recent years the cheapest loans have often been very long loans repayable at maturity.

During 2007/08 the Council rescheduled £70.8m of debt. This involved repaying loans from the Public Works Loans Board (PWLB) early and taking out new loans from the PWLB with longer maturities ranging from 45 to 49 years. The effect of the debt restructuring was to reduce the annual interest payable on the Council's debt and to lengthen the maturity profile of the Council's debt.

£50m of new borrowing was taken in 2008/09 to finance capital expenditure. Funds were borrowed from the PWLB at fixed rates of between 4.45% and 4.60% for between 43 and 50 years.

A further £173m was borrowed in 2011/12 to finance capital expenditure and the HRA Self Financing payment to the Government. Funds were borrowed from the PWLB at rates of between 3.48% and 5.01%. £89m of this borrowing is repayable at maturity in excess of 48 years. The remaining £84m is repayable in equal installments of principal over periods of between 20 and 31 years.

As a result of interest rates in 2007/08 when the City Council rescheduled much of its debt and interest rates in 2008/09 and 2011/12 when the City Council undertook considerable new borrowing 60% of the City Council's debt matures in over 30 years' time. This is illustrated in graph below.



CIPFA's Treasury Management in the Public Services Code of Practice which the City Council is legally obliged to have regard to requires local authorities to set upper and lower limits for the maturity structure of their borrowing. The limits set by the City Council on 22 March together with the City Councils actual debt maturity pattern are shown below.

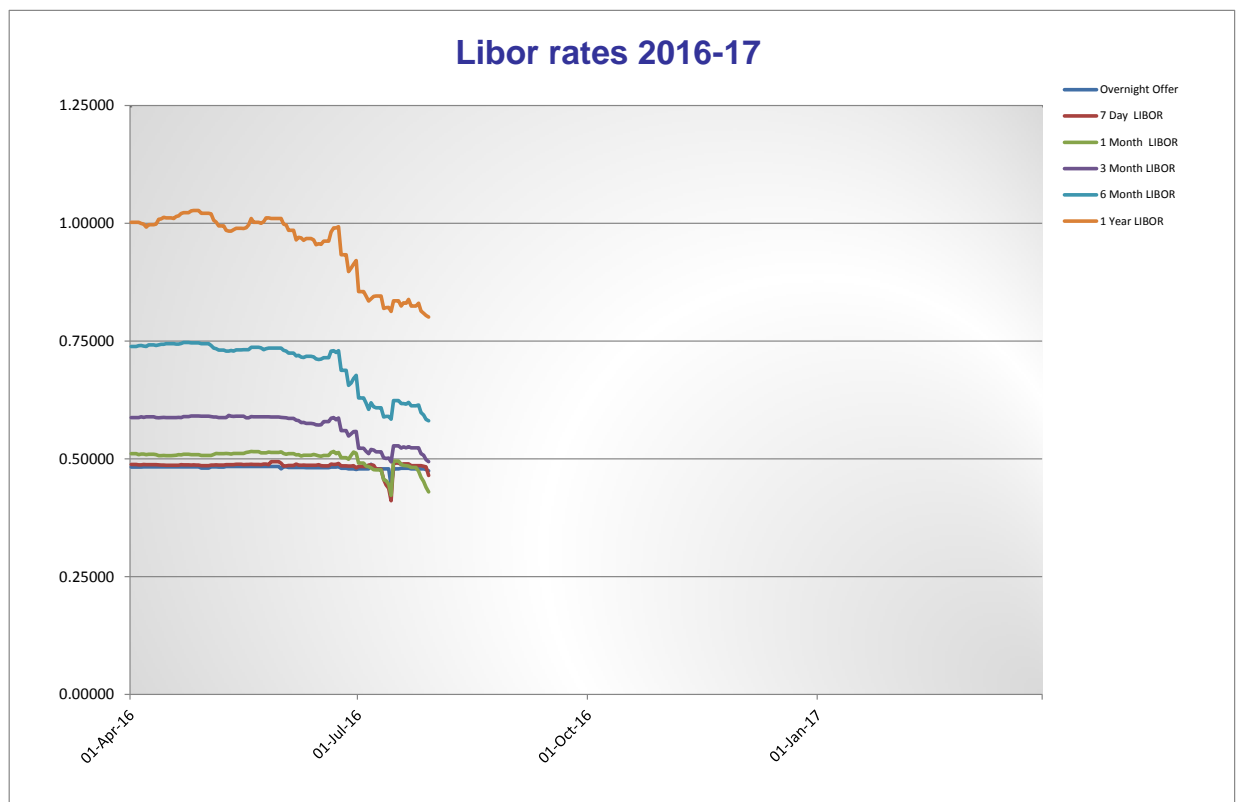
	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	10%	10%	10%	20%	30%	30%	30%	40%
Actual	1%	1%	4%	7%	22%	12%	18%	35%

8. INVESTMENT ACTIVITY

In accordance with the Government's statutory guidance, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

Investment rates available in the market were broadly stable until mid-May but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectations of an imminent cut in Bank Rate and lower for longer expectations thereafter.

Short term market interest rates for the first four months of 2016/17 are shown in the graph below:



The Council's investment portfolio has increased by 35% in 2016/17 from £371.8m on 1 April to £500.7m as at 31 July largely due to borrowing £94m to take advantage of low interest rates. Consequently the Council has invested up to some of its geographical limits. In addition it is becoming harder to find counter parties that will accept the Council's investments and pay good rates of interest.

The overall investment portfolio yield for the first four months of the year is 1.09%.

The Council's budgeted investment return for 2016/17 is £3,184k, and performance for the year to date is £588k above budget. This is due to having more cash to invest than had been anticipated and improved investment returns.

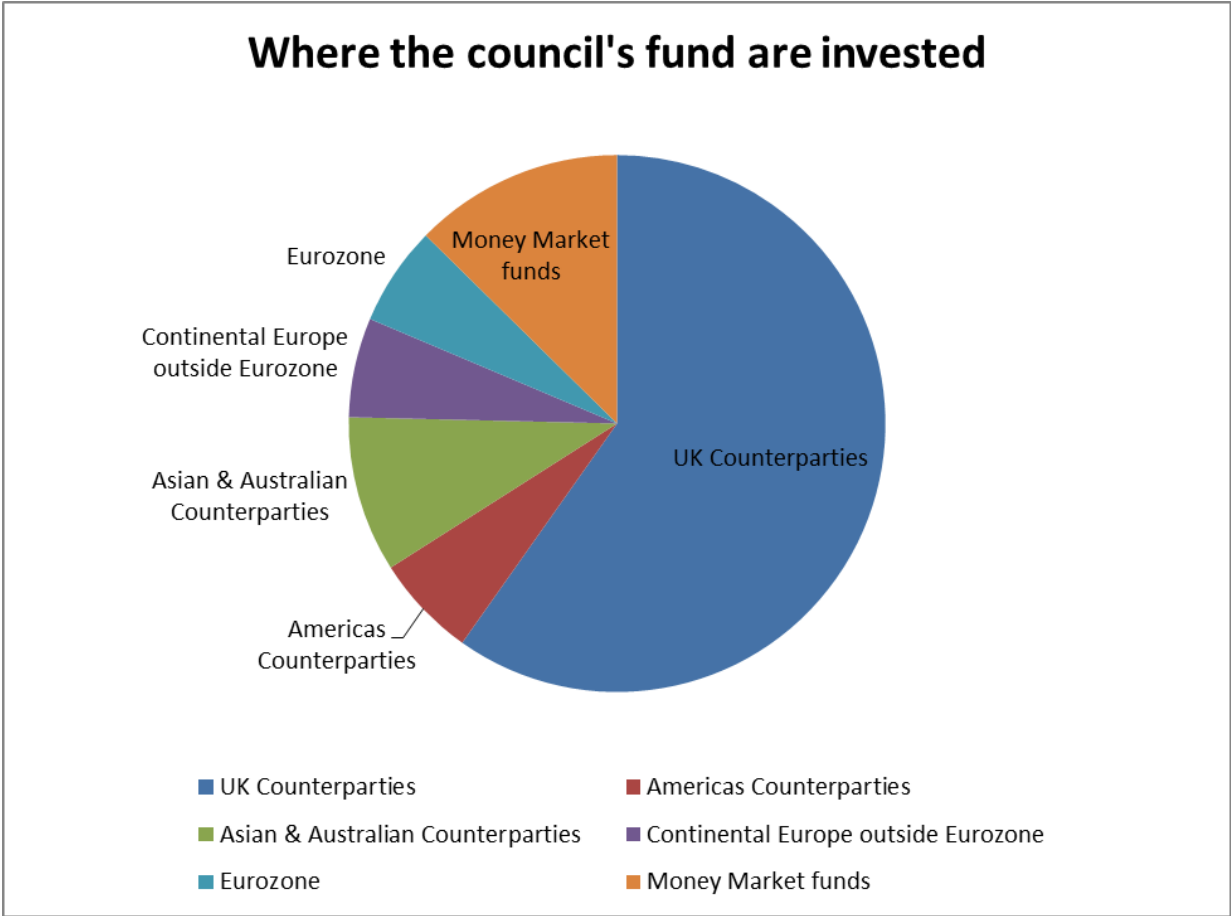
The significant fall in investment rates following the referendum and further likely reductions in investment rates following the Bank of England's reactions are likely to reduce the yield from the investment portfolio.

9. SECURITY OF INVESTMENTS

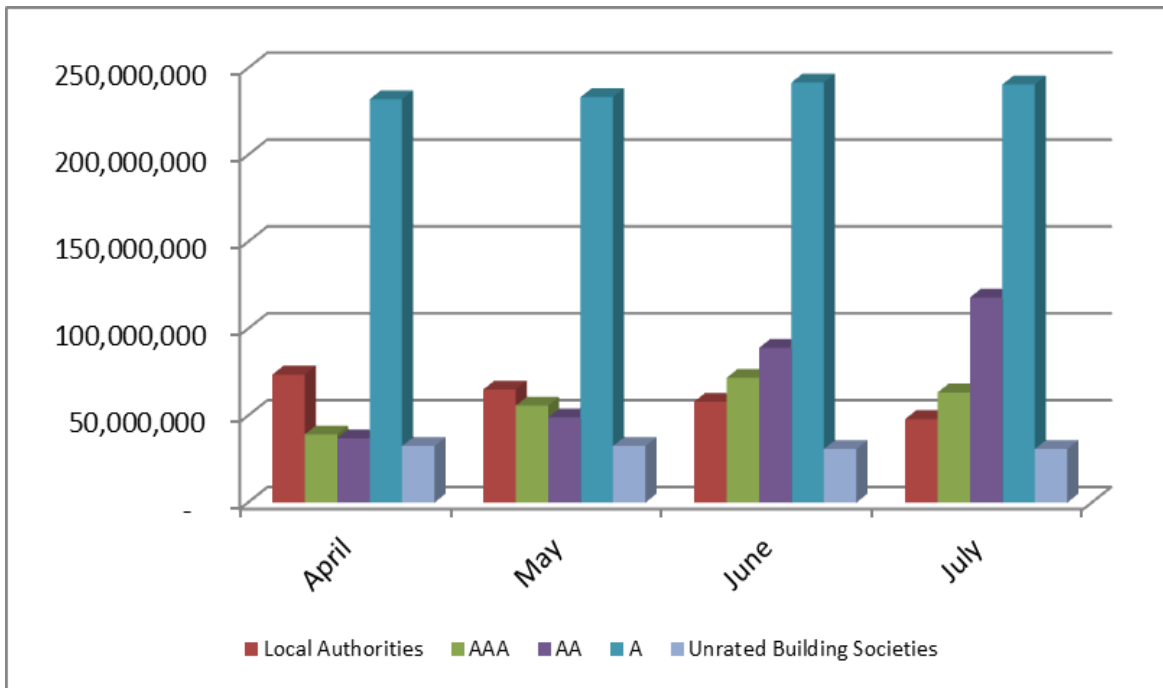
The risk of default has been managed through limiting investments in any institution to £30m or less depending on its credit rating and spreading investments over countries and sectors.

At 31 July 2016 the City Council had on average £8.8m invested with each institution.

The chart below shows where the Council's funds were invested at 31 July 2016.



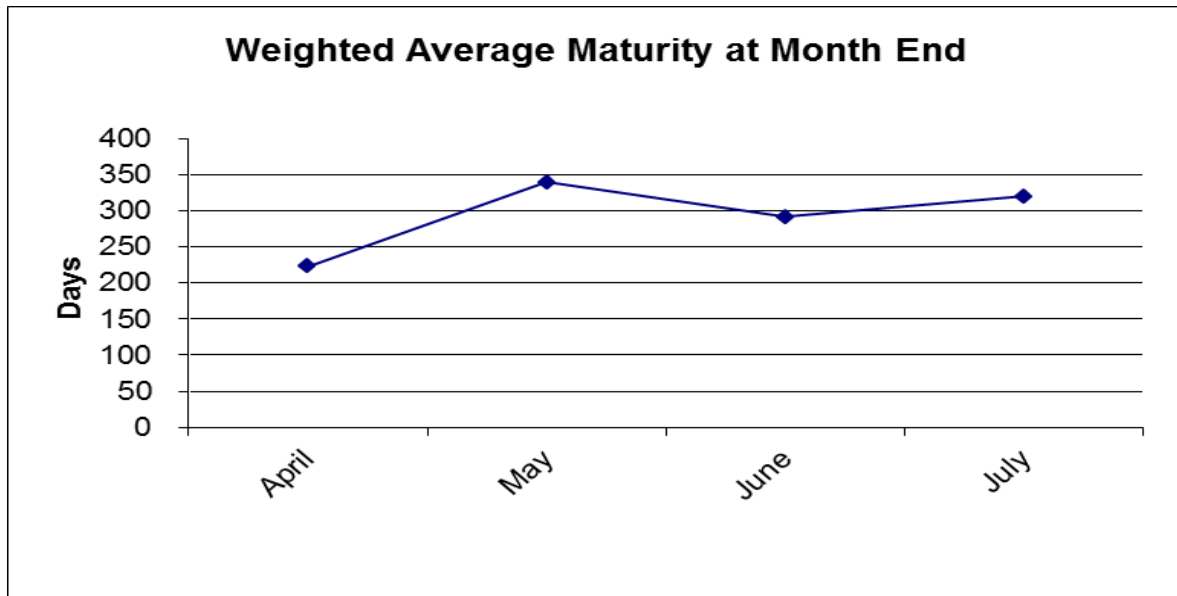
The chart below shows how the Council's investment portfolio has changed in terms of the credit ratings of investment counter parties over the first four months of 2016/17.



It can be seen from the graph above that investments in local authorities have declined over the first four months of 2016/17. These investments have largely been replaced by investments in AA rated counter parties which generally offer a better return than investments in local authorities.

10. LIQUIDITY OF INVESTMENTS

The weighted average maturity of the City Council's investment portfolio started at 223 days in April and increased to 339 days in May reflecting the increased level of cash at the beginning of the year. Since May the weighted maturity of the investment portfolio has been fairly stable. This is shown in the graph below.



The Treasury Management Policy seeks to maintain the liquidity of the portfolio, ie. the ability to liquidate investments to meet the Council's cash requirements, through maintaining at least £10m in instant access accounts. At 31 July £66.3m was invested in instant access accounts. Whilst short term investments provide liquidity and reduce the risk of default, they do also leave the Council exposed to falling interest rates.

Under CIPFA's Treasury Management Code it is necessary to specify limits on the amount of long term investments, ie. investments exceeding 364 days that have maturities beyond year end in order to ensure that sufficient money can be called back to meet the Council's cash flow requirements. The Council's performance against the limits set by the City Council on 22 March 2016 is shown below.

Maturing after	Limit	Actual
	£m	£m
31/3/2017	196	168
31/3/2018	123	90
31/3/2019	90	25

12. INTEREST RATE RISK

This is the risk that interest rates will move in a way that is adverse to the City Council's position.

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes require local authorities to set upper limits for fixed interest rate exposures. Fixed interest rate borrowing exposes the Council to the risk that interest rates could fall and the Council will pay more interest than it need have done. Long term fixed interest rate investments expose the Council to the risk that interest rates could rise and the Council will receive less income than it could have received. However fixed interest rate exposures do avoid the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 22 March 2016 is shown below.

	Limit	Actual
	£m	£m
Maximum Projected Gross Borrowing – Fixed Rate	464	499
Minimum Projected Gross Investments – Fixed Rate	(106)	(211)
Fixed Interest Rate Exposure	358	288

£94m was borrowed to take advantage of the relatively low interest rates in the first 4 months of 2016/17. Although this resulted in the Council having both more fixed rate borrowing and more fixed rate investments than had been anticipated, the overall fixed interest rate exposure limit was not exceeded.

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes also require local authorities to set upper limits for variable interest rate exposures. Variable interest rate borrowing exposes the Council to the risk that interest rates could rise and the Council's interest payments will increase. Short term and variable interest rate investments expose the Council to the risk that interest rates could fall and the Council's investment income will fall. Variable interest rate exposures carry the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 22 March 2016 is shown below.

	Limit	Actual
	£m	£m
Minimum Projected Gross Borrowing – Variable Rate	-	-
Maximum Projected Gross Investments – Variable Rate	(444)	(289)
Variable Interest Rate Exposure	(444)	(289)

The City Council is particularly exposed to interest rate risk because all the City Council's debt is made up of fixed rate long term loans, but most of the City Council's investments are short term. Future movements in the Bank Base Rate tend to affect the return on the Council's investments, but leave fixed rate long term loan payments unchanged. This could favour the City Council if short term interest rates rise.

The risk of a 0.5% change in interest rates to the Council is as follows:

<u>Effect of +/- 0.5% Rate Change</u>	2016/17 (Part Year)	2017/18	2018/19
	£'000	£'000	£'000
Long Term Borrowing	2	55	55
Investment Interest	(1,509)	(1,218)	(803)
Net Effect of +/- 0.5% Rate Change	(1,507)	(1,163)	(748)