Full Council

Thursday, 12th December, 2013, at 1.30 pm or at the conclusion of Question Time, whichever is the later, in the Council Chamber, County Hall, Preston.

Supplementary Agenda

Index

Jo Turton
Interim Chief Executive

County Hall
Preston

06 December 2013

Lancashire County Council

Meeting of the Full Council
Meeting to be held on 12 December 2013

Report submitted by: The Interim Chief Executive

Part A

Electoral Division affected:
None

Report of the Cabinet
(Annexes 1 and 2 refer)

Contact for further information:
Dave Gorman, (01772) 534261, Office of the Chief Executive,
dave.gorman@lancashire.gov.uk

Executive Summary

This report relates to matters considered by Cabinet which require the approval of Full Council:

1. Introduction of the Living Wage for Lancashire County Council Employees

2. Treasury Management Indicators for Interest Rate Exposure

Recommendation

The Full Council is asked to consider the recommendations of the Cabinet set out in the report

Background and Advice

1. Introduction of the Living Wage for Lancashire County Council Employees

The report considered by Cabinet on 7 November is attached at Annex 1. The Cabinet minutes are available via the following link:

http://council.lancashire.gov.uk/ieListDocuments.aspx?CId=122&MId=1900&Ver=4

Cabinet recommended Full Council to approve the proposals for the adoption by the County Council of the Living Wage as set out in the report, on the basis of the proposed phasing arrangements.

2. Treasury Management Indicators for Interest Rate Exposure

The report considered by Cabinet on 5 December is attached at Annex 2. The Cabinet minutes are available via the following link:

http://council.lancashire.gov.uk/ieListDocuments.aspx?CId=122&MId=1901&Ver=4

Cabinet recommended to Full Council that the Treasury Management Strategy be amended to:

(i) Adopt the 'amount of net interest payable' indicator, option C set out at Appendix 'A', in replacement of the current indicator;
(ii) In line with Arlingclose's advice, an upper limit of £5m net interest should be set for variable rate exposure and a limit of £37.6m net interest set for the fixed rate indicator;
(iii) Incorporate the local indicator 'impact of an immediate interest rate rise of 1%' with a maximum limit of £25m.

The Full Council is asked to consider the recommendations of the Cabinet set out above.

List of Background Papers

Paper	Date	Contact/Directorate/Tel
Agenda and Minutes of the Cabinet	7 November 2013 5 December 2013	Dave Gorman/Office of the Chief Executive/ (01772) 534261

Annex 1

Cabinet - 7 November 2013

Report of the Interim Chief Executive

Electoral Division affected: All

Introduction of the Living Wage for Lancashire County Council Employees

Contact for further information:
Eddie Sutton, (01772) 535171, Office of the Chief Executive,
eddie.sutton@lancashire.gov.uk

Executive Summary

The report sets out proposals for Lancashire County Council to become a "Living Wage Employer" through the phased introduction of a Living Wage, currently set at £7.45 an hour (which is being up-rated. The new rate will be announced on 4 November 2013) for Lancashire County Council lowest paid centrally employed staff which will result in:

- The replacement of Grade 1 (spinal column points 5 and 6), Grade 2 (spinal column points 7, 8, 9 and 10) and Grade 3 (spinal column points 9 and 10) with a new Grade 2 (spinal column point 10) of £7.45 an hour; and
- The commencement of Grade 3 (at spinal column point 11); with effect from 1 April 2014, on the terms set out in the report.

Overall, this will impact on 3,638 of Lancashire County Council centrally employed employees who from 1 April 2014 would be paid at least the Living Wage (currently £7.45 an hour).

The report proposes that the position in relation to schools will be the subject of discussion with the Schools Forum with a view to consideration of the adoption of the Living Wage by individual school governing bodies.

The report also proposes that a review be undertaken to consider the benefits to the Lancashire economy and its citizens and the financial implications for the County Council of a broader application of the scheme in respect of organisations that currently provide goods, services and works to the County Council. A further report to be brought to Cabinet at a future meeting.

The financial implications of the introduction of a Living Wage for Lancashire County Council's lowest paid centrally employed staff are set out in the body of this report.

Lancashire County Council

Recommendation

Cabinet is asked to:

(i) Agree to the proposals for a phased introduction of the Living Wage as set out in the report; and:
(ii) Recommend Full Council to approve the proposals for the adoption by the County Council of the Living Wage as set out in the report, on the basis of the proposed phasing arrangements.

1. Background and Advice

The Living Wage is not a new concept. It has been around in its present form since 2005, when it was adopted by the Greater London Authority for its own staff in London. The Living Wage is an informal benchmark, not a legally enforceable minimum level of pay, like the national minimum wage.

The research by the Joseph Rowntree Foundation in 2008 looked at developing a formula for calculating a minimum income standard. For their purposes, a Living Wage could be defined as the level of income needed to provide an acceptable standard of living in Britain to ensure good health, adequate child development and social inclusion. Following detailed research, they concluded that the Living Wage for a single working age adult in the UK was £6.88 an hour in 2008. The basic idea is that these are the minimum pay rates needed to let workers lead a decent life.

The national minimum wage is set by the Chancellor of the Exchequer each year on the advice of the Low Pay Commission. It is enforced by Her Majesty's Revenue and Customs (HMRC).

The Living Wage, apart from in London, is currently calculated and set by the Centre for Research in Social Policy at Loughborough University on an annual basis. The Living Wage is now set at £8.55 an hour in London and £7.45 an hour in the rest of the UK. By comparison, the national minimum wage is significantly lower, at £6.31 an hour for those aged over 21.

Currently in relation to Lancashire County Council staff, 3.4% of the adult full-time workforce and 45.1% of the adult part-time staff (of which 92.7% are employed within Lancashire County Commercial Group (LCCG)), earn less than £7.45 an hour:

So it is this group of workers who would benefit most from uplift in their hourly rates to the Living Wage of £7.45.

There is evidence that the benefits of becoming a Living Wage Employer can include: improved recruitment and retention; higher employee morale; motivation and productivity.

2. Introduction of the Living wage for Lancashire County Council centrally employed employees

Formal Licence of Accreditation is granted by the Living Wage Foundation to those employers who are committed to an agreed timetable of implementation through the award of the "Living Wage Employer" mark. To be accredited as an official "Living Wage Employer" an organisation must:

- Pay all its direct staff at least the Living Wage rate;
- Commit to adjusting this within 6 months of an annual updating;
- Demonstrate progress towards requiring existing and new contractors to do the same.

In order to demonstrate the County Council's immediate commitment to the principles of the Living Wage, the County Council intends to implement the Living Wage as its minimum pay rate for all centrally employed staff, with effect from 1 April 2014 regardless of weekly working hours. This includes employees directly employed by the County Council working in a range of front line roles such as cleaning, catering, caring for older people and school crossing patrols.

It is proposed that the lower spinal column points at Grade 1; Spinal Column Points 4, 5 and 6 and Grade 2; Spinal Column Points 7, 8, 9 and 10 are removed and replaced with a new Grade 2 at a revised single Spinal Column Point 10.

However, regard must be had for the national 2013/14 Pay Agreement which has two elements. Firstly, with effect from 1 April 2013 a 1% increase has been agreed across all pay rates. Secondly, Spinal Column Point 4 has been deleted with effect from 1 October 2013.

The County Council's current hourly rates, at the lower end of the pay range, and the proposed hourly rates, taking into account the 1% pay offer, are detailed in Table One below:

<table>
<tr><th colspan="2">GRADES</th><th>SPINAL COLUMN POINT</th><th>HOURLY RATE PRIOR TO 1ST APRIL 2013 (£)</th><th>PROPOSED HOURLY RATE FROM 1ST APRIL 2013 (£)</th></tr>
<tr><td rowspan="3">Grade 1</td><td rowspan="2"></td><td>4</td><td>6.29</td><td>6.36</td></tr>
<tr><td>5</td><td>6.38</td><td>6.45</td></tr>
<tr><td rowspan="4">Grade 2</td><td>6</td><td>6.47</td><td>6.54</td></tr>
<tr><td></td><td>7</td><td>6.62</td><td>6.69</td></tr>
<tr><td></td><td>8</td><td>6.83</td><td>6.90</td></tr>
<tr><td rowspan="5">Grade 3</td><td>9</td><td>7.04</td><td>7.11</td></tr>
<tr><td></td><td>10</td><td>7.19</td><td>7.26</td></tr>
<tr><td></td><td>11</td><td>7.63</td><td>7.71</td></tr>
<tr><td></td><td>12</td><td>7.79</td><td>7.87</td></tr>
<tr><td></td><td>13</td><td>8.00</td><td>8.09</td></tr>
</table>

Table 1

For the purposes of this report, therefore, the financial implications have been calculated on the basis of the new national Pay Agreement (both the 1% increase with effect from 1 April 2013 and the deletion of Spinal Column Point 4 with effect from 1 October 2013) which now forms the new baseline. The current Living Wage rate of £7.45 an hour has also been used.

It is proposed that the County Council's pay line is amended by replacing Grade 1 (Spinal Column Points 5 and 6); and Grade 2 (Spinal Column Points 7, 8, 9 and 10) with a new Grade 2 (Spinal Column Point 10) of £7.45 an hour for Lancashire County Council centrally employed employees.

It is proposed that the introduction of the Living Wage would be implemented in two phases. The phasing of the introduction of the Living Wage will ensure the lowest paid centrally employed staff will immediately secure a benefit from this initiative.

Phase One

The removal of Spinal Column Points 5 and 6 and the re-grading of all Lancashire County Council centrally employed employees on these Spinal Column Points to Spinal Column Point 7, as the new, minimum Spinal Column Point, at a rate of £6.69 per hour.

All Lancashire County Council centrally employed employees on these Spinal Column Points to be re-graded to Spinal Column Point 7, as the new, minimum Spinal Column Point at a rate of £6.69 an hour, backdated to take effect from 1 October 2013. This is explained in Table Two below:

<table>
<tr><th colspan="2">CURRENT GRADES
(as at 1 October 2013)</th><th>SPINAL COLUMN POINT</th><th>HOURLY RATE WEF 1ST April 2013 (£)</th><th colspan="2">PROPOSED GRADES

(as at 1 October 2013)</th></tr>
<tr><td rowspan="2">Grade 1
164 - 229 NJC points</td><td></td><td>5</td><td>6.45</td><td></td><td></td></tr>
<tr><td rowspan="4">Grade 2
230 – 254 NJC points</td><td>6</td><td>6.54</td><td colspan="2"></td></tr>
<tr><td></td><td>7</td><td>6.69</td><td></td><td rowspan="3">Grade 2
<255 NJC points</td></tr>
<tr><td></td><td>8</td><td>6.90</td><td></td></tr>
<tr><td rowspan="5">Grade 3
255 – 299 NJC points</td><td>9</td><td>7.11</td><td rowspan="5">Grade 3
255 – 299 NJC points</td></tr>
<tr><td></td><td>10</td><td>7.26</td><td></td></tr>
<tr><td></td><td>11</td><td>7.71</td><td></td></tr>
<tr><td></td><td>12</td><td>7.87</td><td></td></tr>
<tr><td></td><td>13</td><td>8.09</td><td></td></tr>
</table>

Table 2

Phase Two

The removal of Spinal Column Points 7, 8, 9 and 10 and creation of a new Grade 2 with a single Spinal Column Point 10 at a rate of £7.45 an hour. All Lancashire County Council centrally employed employees at Spinal Column Points 7, 8, 9 and 10 to be re-graded to the new Grade 2 with a single Spinal Column Point 10 (a Living Wage of £7.45 an hour), with effect from 1 April 2014. This is explained in Table Three below:

PROPOSED GRADES (as at 1 October 2013)		SPINAL COLUMN POINT	HOURLY RATE WEF 1ST April 2013(£)	PROPOSED GRADES (as at 1 April 2014)	
	Grade 2 <255 NJC points	7	6.69		
		8	6.90		
Grade 3 255 – 299 NJC points		9	7.11		
		10	7.26		
		NEW 10	**7.45**		**Grade 2**
		11	7.71	**Grade 3**	
		12	7.87		
		13	8.09		

Table 3

3. Financial Summary

The following information details the financial implications of the recommended, phased approach taking into account the national Pay Agreement of a 1% pay offer and the deletion of Spinal Column Point 4.

Phase One (1 October 2013)

The lowest proposed scale point of the revised pay line will be a new minimum Spinal Column Point 7 at a rate of £6.69 an hour. The following Table four details the number of staff affected and the financial costs in 2013/14 when compared to the approved budget:

Service	No's of Staff	FTE	Cost in 2013/14 £m
Adult and Community Services	56	41	0.011
Children and Young People	99	67	0.016
Environment	38	37	0.010
Office of the Chief Executive	26	25	0.006
County Treasurer's	9	9	0.003
LCCG	2109	671	0.127
Total	2337	850	0.173

Table 4

No staff whose costs fall within the corporate budget, Public Health or who are seconded to One Connect Limited, are affected by these proposals.

The in year increase of £172,612 will be funded from the resources released from the outcome of the recent review of reserves, as set out in the Money Matters report elsewhere on the Cabinet agenda.

Phase Two (1 April 2014)

The lowest proposed scale point of the revised pay line will be a new Spinal Column Point 10 at a rate of £7.45 an hour. The following Table five details the number of staff affected and the financial costs showing the total cost compared to the base position of what is included in the currently approved budget. A greater number of staff are ultimately affected as a wider range of scale points are abolished:

Service	**Total Number of Staff Affected By Phases 1 and 2**		**Phase 1 Cost**	**In Year Phase 2 Cost**	**Total Cost**
	No's of Staff	**FTE**	**£m**	**£m**	**£m**
Adult and Community Services	138	95	0.011	0.133	0.144
Children and Young People	205	110	0.016	0.171	0.187
Environment	38	37	0.010	0.078	0.088
Office of the Chief Executive	36	35	0.006	0.061	0.067
County Treasurer's	9	9	0.003	0.019	0.022
LCCG	3,212	1,241	0.127	1.670	1.797
Total	3,638	1,527	0.173	2.132	2.305

Table 5

As the announcement about any change in the Living Wage will not be made until 4 November 2013, the current Living Wage of £7.45 an hour has been used to calculate the financial impact for the County Council in introducing the Living Wage. However, in advance of this announcement, three scenarios have been tested to model the potential impact of an increase in the Living Wage on the Phase 2 costs of the implementation. In these scenarios, the impact of increases of:

- 2.5 % (the Living Wage would increase to £7.64 an hour);
- 2.7% (the Living Wage would increase to £7.65 an hour); and
- 3% (the Living Wage would increase to £7.67 an hour)

have been modelled, because the key indicator used in the calculation of the increase to the Living Wage is the Consumer Price Index (CPI) which is currently close to 2.7%.

The potential impact on Phase 2 costs is shown in Table 6 below:

Increase in living wage rate from £7.45 ph	**2.5%**	**2.7%**	**3%**
Additional cost:	**£m**	**£m**	**£m**

Adult and Community Services	0.048	0.052	0.057
Children and Young People	0.042	0.045	0.050
Environment	0.017	0.018	0.020
Office of the Chief Executive	0.016	0.018	0.020
County Treasurer's Directorate	0.004	0.005	0.005
LCCG	0.513	0.554	0.616
Total	**0.640**	**0.692**	**0.768**

Table 6

This shows that the additional financial costs to the County Council from paying the Living Wage in 2014/15 could potentially be between £0.640m to £0.768m depending upon the level of increase announced on 4 November.

A verbal update will be provided to Cabinet at the meeting following the announcement of any change to the amount of the Living Wage.

In the event that Cabinet recommends Full Council to approve the proposals for the adoption by the County Council of the Living Wage as set out in this report and Full Council agrees to this recommendation, then the financial implications for 2014/15 and onwards will be addressed as part of the County Council's budget setting.

4. Lancashire Schools

The work undertaken to date has demonstrated that circa 5,200 staff (1,800 full time equivalents) working in schools are currently paid an hourly rate which is less than the Living Wage rate of £7.45 per hour. The introduction of a Living Wage for staff working in schools will be discussed with the Schools Forum. The decision as to whether to adopt the Living Wage sits with the individual Governing Body of each school. It is proposed that schools will be encouraged to consider adopting the Living Wage as a minimum pay rate from 1 April 2014.

5. Contractors

As outlined above, as part of the Living Wage Accreditation, the County Council needs to demonstrate progress towards requiring existing and new contractors to adopt the Living Wage. Therefore it is proposed that a review be undertaken to consider the benefits to the Lancashire economy and its citizens, and the financial implications for the County Council of a broader application of the scheme in respect of organisations that currently provide goods, services and works to the County Council. A further report will be brought to Cabinet at a future meeting.

Consultations

Officers have consulted with the Joint Negotiating and Consultative Forum (JNCF).

Implications:

This item has the following implications, as indicated:

Risk management

Financial Implications

Adoption of the Living Wage results in a further pressure within the County Council's forward financial forecast that will need to be managed as part of the delivery of the overall Medium Term Financial Strategy, and this will be reflected in the budget proposals that will be brought to Cabinet in due course.

Adoption of the Living Wage also changes the Council's financial risk profile in two specific ways.

Firstly, increases in the Living Wage are not the result of the national pay negotiations for local government staff and have to date been at a rate in excess of that reflected in the national agreements which are reflected in the County Council's financial planning framework. Thus there is likely to be a further pressure in terms of pay costs that will need to be reflected in future iterations of the Medium Term Financial Strategy.

The impact of introducing the Living Wage is greatest within LCCG which is heavily dependant for its success on winning contracts in competition with the private sector. Clearly a significant change in the cost base of this sort could have an impact on the relative competitive position of LCCG, particularly in the high competition areas of cleaning and catering. Clearly management within LCCG will take steps to mitigate any competitive impact, as was the case with the equal pay review and the nature and scale of this impact will only become clear as current contracts are renewed.

Legal Implications

The County Council's current pay and grading structure was implemented at the conclusion of the Equal Pay Review in March 2010. The purpose of the review was to implement The National Joint Council for Local Government Services 2004 Pay Agreement which included a requirement for Councils to undertake an equal pay review of pay and terms and conditions of employment in accordance with Part 3 of the National "Green Book" Conditions. The implementation of single status employment and fair and non-discriminatory grading structures was to ensure that the Council complies with equalities legislation by ensuring that differences in pay and other terms and conditions are based upon objective factors and not gender.

The introduction of the Living Wage does not have any obvious equal pay or other equality implications. In the event of a claim being brought the Council could defend the matter on the basis that any alleged inequality is genuinely due to a material factor which is not a difference in sex, age, etc and that the introduction of the Living Wage is a proportionate means of achieving a legitimate aim; the reasons for the introduction of the Living Wage being the factors identified under the "Background" section above.

HR Implications

Under the terms of a Collective Agreement between the County Council and the recognised Trade Unions, the County Council has committed to undertake a review of the Living Wage.

List of Background Papers

Paper	Date	Contact/Directorate/Tel
Joseph Rowntree Foundation – 'A Minimum Income Standard for Britain' http://www.jrf.org.uk/publications/minimum-income-standard-britain-what-people-think	1 July 2008	Eddie Sutton, Office of the Chief Executive, (01772) 535171

Reason for inclusion in Part II, if appropriate

N/A

Annex 2

Cabinet - 5 December 2013

Report of the County Treasurer

Electoral Division affected: All

Treasury Management Indicators for Interest Rate Exposure
(Appendix A refers)

Contact for further information:
Mike Jensen, (01772) 534742, County Treasurer's Directorate,
mike.jensen@lancashire.gov.uk

Executive Summary

The CIPFA Treasury Management Code of Practice obliges local authorities to set, monitor and report on several treasury management indicators, including the setting of upper limits on the level of exposure to both fixed and variable interest rates. This is an important tool in managing the financial affairs of the County Council as it is intended to limit the risks the Council is exposed to through by short term borrowing and long-term investments i.e. the risk that changes in interest rates will create an unexpected or unbudgeted burden on the Council's finances.

This report sets out the issues regarding the current indicator, and proposes changes which will enable the indicator to support the County Treasurer in her assessment of the County Council's financial health (including exposure to financial risk) and enable a greater level of assurance to be provided to Cabinet in relation to treasury management activity.

Following advice received from the County Council's treasury management advisers, Arlingclose Ltd, on the way that the Council's bond portfolio should be reflected in the calculation of the indicator, in relation to the Council's exposure to fixed and variable interest rates, the indicator is no longer fit for purpose.

There are a number of options available, but Arlingclose Ltd recommends the use of an indicator which sets an upper limit on interest rate exposure based on the net interest payable by the County Council – which takes into account interest received on investments and paid on borrowing. The indicator would provide assurance on the Council's Treasury Management activities as it is will allow more short-term borrowing while interest rates are low, but force the Council to move progressively to borrowing at fixed rates as rates rise, which is in underlying principle behind the Council's approach to treasury management.

Lancashire County Council

Recommendation

That Cabinet recommends to Full Council that the Treasury Management Strategy be amended to:

(i) Adopt the 'amount of net interest payable' indicator, option C set out at Appendix 'A', in replacement of the current indicator;
(ii) In line with Arlingclose's advice, an upper limit of £5m net interest should be set for variable rate exposure and a limit of £37.6m net interest set for the fixed rate indicator;
(iii) Incorporate the local indicator 'impact of an immediate interest rate rise of 1%' with a maximum limit of £25m.

Background and Advice

Treasury management is the management of the County Council’s investments and cash flows, its banking, money market and capital market transactions; it also includes the effective control and management of the risks associated with these activities, ensuring that the Council gets the best performance for the least risk.

The Treasury Management Strategy sets out the Council’s policies for ensuring the security and liquidity of its investments, whilst having regard to investment returns in order to protect the value of the funds. It also outlines the Council's strategy for financing existing borrowing and future capital borrowing requirements, with the aim of securing the required funds at the lowest possible rate.

The strategy also includes a set of indicators known as Treasury Management Indicators which set boundaries on treasury management activities for risk management purposes. This report recommends a change to the fixed and variable interest rate indicators, with detailed information set out in Appendix A to this report.

Consultations

Arlingclose Ltd. Treasury Management Consultants

Implications:

This item has the following implications, as indicated:

Risk management

Legal

The County Council must adhere to the "Prudential Code for Treasury Management in Local Authorities".

Financial

The Treasury Management Indicators ensure the County Council operates within the agreed Treasury Management Strategy. The objective of the Treasury Management Strategy is to ensure the security and liquidity of the County Council's debt and investment portfolios, and to improve investment returns and reduce borrowing costs while reducing the financial risks to which the Council is exposed. The forecast impact of these strategic decisions is reflected in the Medium Term Financial Strategy.

List of Background Papers

Paper	Date	Contact/Directorate/Tel
Treasury Management Strategy 2013/14	February 2013	Andy Ormerod, County Treasurer's Directorate, (01772) 534740

Reason for inclusion in Part II, if appropriate

N/A

Treasury Management Indicators for Interest Rate Exposures

1. Background

The CIPFA Treasury Management Code of Practice obliges local authorities to set, monitor and report on several treasury management indicators, including the setting of upper limits on the level of exposure to both fixed and variable interest rates. This is an important tool in managing the financial affairs of the Council as it is intended to limit the risks the Council is exposed to through by short term borrowing and long-term investments i.e. the risk that changes in interest rates will create an unexpected or unbudgeted burden on the Council's finances.

The indicator currently reported for fixed and variable rate exposures is a maximum of £220m on both fixed and variable exposures. This indicator has a dual purpose – it provides management information to the County Treasurer on a monthly basis in order to consider as part of the financial health of the organisation, but also provides assurance to members on treasury management activity. It is important therefore, that the indicator provides an appropriate measure which can be relied upon.

2. Current Position

The Council's investment strategy is designed to reduce credit risk by accessing high credit quality institutions through bond investments as opposed to placing fixed term deposits directly with banks. This continues to be the County Council's preferred strategy given the continued difficult credit environment.

However, following advice received from the County Council's treasury management advisers, Arlingclose Ltd, the way that the Council's bond portfolio should be reflected in the calculation of the indicator means as a consequence of this, the current methodology of calculating the Council's exposure to fixed and variable interest rates is no longer fit for purpose. The indicator currently reported for fixed and variable rate exposures is a maximum of £220m for both fixed and variable interest rate exposures. As a result of the inclusion of the bond portfolio as a variable rate investment, the Council has been over the limit for the variable rate exposure since June 2013. In addition, the Council is required to treat both borrowing and investments that mature within the financial year as variable, even though the interest rate on these instruments is at a fixed rate.

It is vital that the indicators used support the oversight of the treasury management strategy, and do not cause a change in strategy as a result of no longer being fit for purpose. The current strategy remains appropriate within the current economic context and it must be stressed that the above is an indicator not a limit.

However the Council's advisers, Arlingclose have been consulted on how to revise this indicator within the Code of Practice in order to effectively manage and have oversight of the Council's treasury management activities.

3. Interest Rate Risk Indicators Options for measurement

The Code of Practice gives four options for indicators on interest rate exposures.

- Option A - Amount of net principal borrowed – which is the current measurement
- Option B - Proportion of net principal borrowed
- Option C - Amount of net interest payable
- Option D - Proportion of net interest payable.

All the options are calculated based on net figures, recognizing that interest rate risk can be minimized by matching the maturity profiles of the borrowing and investment portfolios, so the interest rate risk of variable rate borrowing can be offset by holding variable rate investments.

Options B and D are considered unsuitable because the method of calculation does not reflect adequately the bond portfolio and would result in percentages that are either negative or greater than 100% which would not support the management process or provide assurance to members.

Arlingclose recommend the use of option C – expressing upper limits for interest rate exposure in terms of net interest payable. The advantage of this method is that it will allow more short-term and variable rate borrowing while market rates are low, but force the Council to progressively more short term and variable rate borrowing while market rates are low but force progressively more to be borrowed at fixed rates as rates rise, which is in underlying principle behind the Council's approach.

The fixed rate indicator would need to be set high enough to enable all borrowing to be at fixed rates. The County Council currently holds a total of £536m of variable rate borrowing, and £312m at a fixed rate of 3.45%. The fundamental premise is that once interest rates begin to rise, the Council will "lock" its borrowing at the lowest rate possible in order to minimise debt costs. To achieve this there must be a clearly defined trigger point at which the move from variable rate borrowing to fixed rate borrowing is made. It is the recommendation of the Chief Investment Officer that this be set at 5%. An upper limit of £37.6m would allow the current variable borrowing to be taken at a fixed rate of 5% in addition to the fixed rate borrowing already in place.

4. Additional Local Indicator – impact of a 1% rise

The Code of Practice encourages local authorities to set additional local indicators, where these would be more suited to local circumstances and would assist local management processes. A local indicator suggested by Arlingclose is to measure the exposure to interest rate risk using the same method as in the Council's annual statement of accounts.

This shows the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year, covering both investments and borrowings and clearly sets out the level of exposure to financial risk, which must then be considered alongside the probability of interest rate changes.

One of the principles of the Treasury Management strategy is to enable the Council to manage financial risk, but to do so effectively it must consider the risk to the Council's financial position. This "local indicator" is currently considered as part of the County Treasurer's management of the treasury management strategy, but is suggested is incorporated into reports to members. Whilst this approach does not reflect accurately the complexity of the financial markets as interest rates do not unilaterally move by the same percentage, it is a good proxy for the overall impact.

As at 30 September, the calculation of the indicator demonstrates that the overall financial impact of a 1% increase in interest rates is £7.3m, taking into account the impact on both borrowing and investment.

The current treasury management strategy assigns a maximum limit of £25m for short term fixed deposit investments with UK and overseas banks holding current minimum credit ratings of P1/A1/F1. Arlingclose suggest that a similar limit could be put against the impact of a 1% rise indicator as the maximum amount of interest rate risk allowable under the policy.

Alongside this the Council should present the local indicator 'impact of an immediate interest rate rise of 1%' with a limit of £25m.

The County Treasurer monitors the interest rate situation closely to ensure that action is taken to ensure the Council's revenue budget is safeguarded; this indicator will give an additional means of assurance for members in relation to this.

If agreed by Cabinet, the revised indicators will be included in a revised Treasury Management Strategy which will be presented to the meeting of the Full Council for approval on 12 December 2013.