

## Wiltshire Council

### Cabinet

25 January 2011

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**Subject:** Treasury Management Strategy 2011-12

**Cabinet Member:** Councillor Fleur de Rhé-Philippe  
Finance, Performance and Risk

**Key Decision:** No

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#### Executive Summary

This report presents the Treasury Management Strategy for 2011-12 including:

- a) The Prudential and Treasury Indicators for the next three years;
- b) Other debt management decisions required for 2011-12 that do not feature within the indicators; and
- c) The Annual Investment Strategy for 2011-12.

#### Proposals

The Cabinet is requested to recommend that the Council:

- a) adopt the Prudential and Treasury Indicators (Appendix A);
- b) adopt the Annual Investment Strategy (Appendix B);
- c) delegate to the Chief Finance Officer the authority to vary the amount of borrowing and other long term liabilities within both the Treasury Indicators for the Authorised Limit and the Operational Boundary;
- d) authorise the Chief Finance Officer to agree the restructuring of existing long-term loans where savings are achievable or to enhance the long term portfolio;
- e) agree that short term cash surpluses and deficits continue to be managed through temporary loans and deposits; and
- f) agree that any long term surplus cash balances not required to cover borrowing are placed in authorised money-market funds, particularly where this is more cost effective than short term deposits and delegate to the Chief Finance Officer the authority to select such funds.

#### Reasons for Proposals

The proposals are required to comply with statutory guidance and reflect best practice.

**Michael Hudson**  
Interim Chief Finance Officer

## Wiltshire Council

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### Purpose of Report

1. This report asks the Cabinet to consider and recommend that the Council approve the Prudential and Treasury Indicators, together with the Treasury Management Strategy for 2011-12.

### Background

2. The Council is required by legislation to approve a Treasury Management Strategy, which incorporates the setting of Prudential and Treasury Indicators and an Annual Investment Strategy, before the start of the financial year.
3. A review of the position in the current year is included elsewhere on the agenda as part of the Interim Report.

### Main Considerations for the Cabinet

#### Prudential Indicators (Prls) and Treasury Indicators (Trls)

##### *Basis of the Indicators*

4. A summary of the Prls and Trls is shown in Appendix A. The key indicators are the Treasury Indicators relating to the Authorised Limit (Trl 1) and the Operational Boundary (Trl 2), which control the Council's exposure to debt.
5. The Prls and Trls have been set on the basis of all known commitments and the effect of all known revenue and capital proposals relating to the council, including those that will be outlined in the appropriate reports to Cabinet at its meeting on 8 February 2011.

##### *Monitoring and Reporting of the Prudential Indicators*

6. Progress will be monitored against the Prls and Trls throughout the year, particularly against the two borrowing limits. Cabinet will be kept informed of any issues that arise, including potential or actual breaches. Members will receive monthly capital monitoring reports and an Interim Report on Treasury Management Strategy for 2011-12 in December 2011.

7. The elements within the Authorised Limit and the Operational Boundary, for borrowing and other long term liabilities require the approval of the Council. In order to give operational flexibility, Members are asked to delegate to the Chief Finance Officer the ability to effect movements between the two elements where this is considered necessary. Any such changes will be reported to Members. The operational boundary is a key management tool for in-year monitoring. It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate. Any breach of the operational boundary will be reported to members immediately. The authorised limit will in addition need to provide headroom over and above the operational boundary, sufficient for example for unusual cash movements and should not be breached.

### Other Debt Management Issues

#### *External v. Internal Borrowing*

8. This Council currently has a difference between gross debt and net debt of £77 million which is represented by investments. This is better illustrated by stating the councils gross debt (borrowing) as £205 million, less investments, i.e. the difference, of £77 million giving the Councils net debt position of £128 million. This is not considered to be a significant difference in terms of the requirements of the Prudential Code.
9. The next financial year is expected to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
10. Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.
11. However, short term savings by avoiding new long term external borrowing in 2011-12 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when Public Works Loans Board (PWLB) long term rates are forecast to be significantly higher.
12. The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions. However, the introduction by the PWLB of significantly lower repayment rates than new borrowing rates in November 2007, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that large premiums would be incurred by such action and would also do so in the near term; such levels of premiums cannot

be justified on value for money grounds. This situation will be monitored in case these differentials are narrowed by the PWLB at some future date.

13. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.
14. In determining whether borrowing will be undertaken in advance of need the Council will:
  - a) ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
  - b) ensure the ongoing revenue liabilities created and the implications have been considered and fed into the business plan;
  - c) evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
  - d) consider the merits and demerits of alternative forms of funding;
  - e) consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
  - f) consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

#### *Debt Rescheduling*

15. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events.
16. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO (Lenders Option Borrowers Option) loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.
17. As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short

term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the Council's maturity profile as in recent years there has been a skew towards longer dated PWLB.

18. The reasons for any rescheduling to take place will include:
  - a) the generation of cash savings and / or discounted cash flow savings;
  - b) helping to fulfil the borrowing strategy; and
  - c) enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
19. Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
20. All rescheduling will be reported to the Cabinet at the earliest meeting following its action.
21. The current average interest rate for the Council overall is 4.33%, which is one of the lowest rates of interest when compared with the latest available information available in respect of other English local authorities.
22. It is proposed that the Chief Finance Officer should continue to be authorised to act on advice from the Council's treasury adviser should rescheduling opportunities arise. Any rescheduling will be reported to Cabinet members.

#### *Lender Option Borrower Option (LOBO) Market Loans*

23. Wiltshire Council currently has borrowings of £61 million in LOBO loans.
24. There are basically two main types of LOBO loan (of which the Council has a both in it's portfolio):
  - a) a loan with an 'initial period' at a relatively low rate of interest, on the completion of which the rate will automatically increase to a 'secondary rate' under the terms of the loan agreement. The interest rate is then subject to 'call option dates' at certain predetermined stages (e.g. every six months, every five years) over the life of the loan, at which time the lender has the option to set a revised interest rate and the borrower has the option to repay the loan without penalty; or
  - b) a loan subject to 'call option dates' only (i.e. there is no 'secondar rate') at which time the lender has the option to raise the interest rate and the borrower has the option to repay the loan without penalty.
25. If the lender exercises his option to revise the interest rate at one of the 'call option dates', the Council will always exercise its option to repay the loan.

Consideration will then be given to rescheduling the debt where the overall level of debt prior to the repayment needs to be maintained.

#### *Short Term Cash Deficits*

26. Temporary loans, where both the borrower and lender have the option to redeem the loan within twelve months, are used to offset short term revenue cash deficits. They may also be used to cover short term capital requirements until longer term loans become more cost effective. The majority of these loans will be at fixed interest rates, maturing on specific dates. It is recommended that the Council continue to utilise temporary loans for any short term cash deficits that arise in respect of revenue and/or capital.

#### Cash Investments

##### *Annual Investment Strategy*

27. The Annual Investment Strategy for 2011-12, which sets out the policy framework for the investment of cash balances, is shown in Appendix B.

##### *Short Term Cash Surpluses*

28. It is anticipated that temporary short term cash surpluses will arise regularly during the year. Investment of these surpluses should be in specific investments (e.g. short term Sterling investments of less than one year). Such investments will normally be short term deposits maturing on specific dates that reflect cash flow requirements at the date the deposit is made. However, under certain market conditions, money market funds will be used, particularly if they provide improved returns.

##### *Longer Term Cash Surpluses*

29. Some cash surpluses, for example core revenue balances, net creditors, accrued reserves and special funds such as those for insurance and PFI can be invested on a long term basis. These cash surpluses may be used for capital financing requirements, where longer term interest rates mean that it is less cost effective to take out longer term loans.
30. Improved returns may be obtained by placing these surpluses in money market funds. The Chief Finance Officer has delegated authority to select money market funds and appoint External Cash Managers within the current approved strategy and it is recommended that this authority is retained.
31. The proposed Investment Strategy for 2011-12 includes the use of unspecified investments (e.g. more than 12 months to maturity and for which external professional advice is required) that the Council's treasury adviser may recommend for investment of longer term cash surpluses such as a PFI Sinking Fund.
32. Although the Council has been well positioned in terms of the balance between both loans and investments, rates of interest paid on deposits have been fairly static over the last financial year. Following a further period of similarly low rates, interest rates are not expected to rise until quarter 4

(October to December) 2011. However, the Monetary Policy Committee is beginning to signal a rise in the Bank Rate may be on the way.

### *Icelandic Deposits*

33. The position in respect of the £12 million investment 'caught up' in the collapse of the Icelandic banks, Heritable (£9 million) and Landsbanki (£3 million) is that the Council has received just over £4 million from Heritable (about 45p in the £), with a further payment expected in January 2011.
34. The Council has yet to receive any repayments from Landsbanki.
35. Distributions from Landsbanki are currently subject to the outcome of legal proceedings in relation to a challenge from other (non priority) creditors, mainly bond holders, in respect of the decision of the Landsbanki Winding up Board to grant priority status to local authorities. According to the latest available information, the trial of test cases (one of which is Wiltshire Council) has been provisionally listed for early/mid February 2011.
36. Following its conclusion, repayments from the administrators of Landsbanki are not then expected to commence until later in 2011, dependent on appeals and it is anticipated that the total repayment will be phased over several years, with the final repayment expected in 2018.
37. It is still anticipated that the Council will eventually recover 80% to 95% of its original investment.

### Minimum Revenue Provision

38. The minimum revenue provision (MRP) is the amount set aside for the repayment of the debt as a result of borrowings made to finance capital expenditure.
39. In accordance with Local Authorities (Capital Finance and Accounting) Regulations 2008 the council adopted a MRP annual policy in May 2009.
40. For financial year 2010-11 the annual policy remained unchanged, in that a regulatory method of setting aside 4% of the borrowing requirement for supported borrowing and an asset life method calculation for any unsupported borrowing was applied.
41. It is proposed that this policy is retained in 2011-12.

### Environmental and Climate Change Considerations

42. a) to d) None have been identified as arising directly from this report.

### Equalities Impact of the Proposal

43. None have been identified as arising directly from this report.

## **Risk Assessment and Financial Implications**

44. The primary treasury management risks to which the Council is exposed are adverse movements in interest rates and the credit risk of its investment counterparties (the organisations with which the Council deposits cash surpluses).
45. The strategies in Appendices A and B take account of the forecast movement in interest rates and allow sufficient flexibility to vary strategy if actual movements in interest rates are not in line with the forecast.
46. The Council's treasury adviser is currently predicting the following interest rate movements:
  - a) the Bank Rate has remained at 0.50% since March 2009. It is expected to rise to 0.75% by the end of the last quarter of 2011, rising further to 1.00% by the end of the first quarter of 2012. Then it is expected to rise to 3.25% by the end of the first quarter of 2014;
  - b) short term PWLB borrowing rates are expected to rise from 3.41% to 3.50% during 2011 and rise to 5.00% by the end of March 2014;
  - c) medium term PWLB borrowing rates are expected to rise from 5.29% to 5.30% during 2011, rising to 5.70% by the end of March 2014; and
  - d) long term PWLB rates are expected to rise to 5.30% (from 5.21%) during 2011 and then rise to 5.70% by the end of quarter one 2014.
47. Interest rates have remained relatively static during 2010, following on from the economic downturn during late 2008 and through 2009. Based on the latest forecast, interest rates are not expected to rise until the end of 2011.
48. The risk that counterparties are unable to repay investments could jeopardise the Council's ability to meet its payments. Investment counterparty risk is controlled by using suitable criteria for assessing and monitoring credit risk, including the use of an up to date lending list. The lending list is based on counterparty categories relating to country, type, sector, maximum investment, and maximum duration of investment (see Appendix B). The Council uses the credit worthiness service provided by its treasury advisers, which is a sophisticated modelling approach incorporating the credit ratings of all three major credit rating agencies, together with 'overlays' of Credit Default Swap (CDS) spreads (default risk), credit watches, credit outlooks and sovereign ratings from the agencies (a more detailed explanation is included within the Annual Investment Strategy in Appendix B).
49. The financial implications of the strategies discussed in this report are fully reflected within the revenue and capital budget figures which will be reported at the Cabinet meeting on 8 February 2011.

## **Legal Implications**

50. None have been identified as arising directly from this report.



## **Options Considered**

51. The options in relation to the revenue and capital budgets in these proposals are fully consistent with the figures included within the budget considerations which will be presented to Cabinet at its meeting on 8 February 2011.

## **Conclusion**

52. The Cabinet is requested to recommend that the Council:
- a) adopt the Prudential and Treasury Indicators (Appendix A);
  - b) adopt the Annual Investment Strategy (Appendix B);
  - c) delegate to the Chief Finance Officer the authority to vary the amount of borrowing and other long term liabilities within both the Treasury Indicators for the Authorised Limit and the Operational Boundary;
  - d) authorise the Chief Finance Officer to agree the restructuring of existing long-term loans where savings are achievable or to enhance the long term portfolio;
  - e) agree that short term cash surpluses and deficits continue to be managed through temporary loans and deposits; and
  - f) agree that any long term surplus cash balances not required to cover borrowing are placed in authorised money-market funds, particularly where this is more cost effective than short term deposits and delegate to the Chief Finance Officer the authority to select such funds.

**Michael Hudson**  
**Interim Chief Finance Officer**

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Report Author:

Keith Stephens, Principal Accountant – Treasury and VAT, Tel: 01225 713603,  
email: [keith.stephens@wiltshire.gov.uk](mailto:keith.stephens@wiltshire.gov.uk)

## **Background Papers**

The following unpublished documents have been relied on in the preparation of this Report: NONE

## **Appendices**

Appendix A Prudential and Treasury Indicators for 2011-12, 2012-13 & 2013-14  
Appendix B Annual Investment Strategy for 2011-12

## Prudential and Treasury Indicators for 2011-12, 2012-13 & 2013-14

- The Prudential and Treasury Management Codes and Treasury Guidelines require the Council to set a number of Prudential and Treasury Indicators for the financial year ahead. This appendix sets out the indicators required by the latest codes analysed between Prudential Indicators and Treasury Indicators.

### Prudential Indicators

#### Prl 1 – Capital Expenditure

- This Prl shows the actual and anticipated level of capital expenditure for the five years 2009-10 to 2013-14. The three years 2011-12 to 2013-14 are discussed in detail in the Capital Programme Proposals 2011-12 to 2013-14 report which will be submitted to Cabinet at its meeting on 8 February 2011.

Department	2009-10 Actual £ million	2010-11 Expected £ million	2011-12 Estimate £ million	2012-13 Estimate £ million	2013-14 Estimate £ million
<b>Capital Expenditure</b>	<b>107.2</b>	<b>124.3</b>	<b>146.9</b>	<b>66.0</b>	<b>15.5</b>

- The capital expenditure figures shown in Prl 1 assume a certain level of financing from borrowing each year. New and existing borrowing needs to be affordable and sustainable. There is a detailed discussion on the policy on borrowing for capital purposes in the Capital Programme Proposals 2011-12 to 2013-14 report.

#### Prl 2 – Ratio of Financing Costs to Net Revenue Stream

- Prl 2 expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as similar credit arrangements, reduced by interest receivable in respect of cash investments.

	2009-10 Actual £ million	2010-11 Expected £ million	2011-12 Estimate £ million	2012-13 Estimate £ million	2013-14 Estimate £ million
Financing Costs	15.8	19.0	21.7	24.6	28.9
Net Revenue Stream (est.)	344.6	346.2	328.9	318.3	326.1
<b>Financing Costs as a percentage of Revenue Budget</b>	<b>4.6%</b>	<b>5.5%</b>	<b>6.6%</b>	<b>7.7%</b>	<b>8.9%</b>

## Prudential and Treasury Indicators for 2011-12, 2012-13 &amp; 2013-14

5. The cost of financing will rise, partly due to the reduction in Government grant, as a consequence of the comprehensive spending review and proportionately over the reporting period because of the effect on financing costs where 'new debt' is expected to rise faster than 'old debt' is repaid. Previously the rise in financing costs was not an affordability issue as the new borrowing taken out was supported by Revenue Support Grant. Only by the use of continued Unsupported Borrowing was there any pressure on the Council Tax.
6. However, the changes to the Revenue Support Grant mechanism that were introduced for 2006-07 and later years (specifically the grant "floor") mean that the Council may not be able to afford the financing costs of all the supported capital expenditure indicated by the Government, because we do not receive the full grant. This has the effect of "levelling the playing field" so that support for capital borrowing has to be considered alongside all other revenue priorities in the budget process. Support for capital can no longer be "passported" automatically.

Prl 3 – Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

7. Prl 3 represents the potential increase in Council Tax required to fund the planned increase in the capital budget for the forthcoming year and future years as a proportion of the tax base at Band D.

	2011-12 £	2012-13 £	2013-14 £
Effect on Band D Council Tax	3.15	7.09	12.20

Prl 4 – Net Borrowing and the Capital Financing Requirement

8. Prl 4 measures the so-called "Golden Rule" and focuses on prudence. Its purpose, as described in the Prudential Code, is: *"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two years"*.
9. The Capital Financing Requirement (CFR) increases whenever capital expenditure is incurred. If resourced immediately (from capital receipts, direct revenue contributions or capital grant/contributions) the CFR will reduce at the same time that the capital expenditure is incurred, resulting in no net increase in CFR.
10. Where capital expenditure is not resourced immediately, there is a net increase in CFR, represented by an underlying need to borrow for capital purposes, whether or not external borrowing actually occurs. The CFR may then reduce over time through future applications of capital receipts, capital grants/contributions or further charges to revenue.

**Prudential and Treasury Indicators for 2011-12, 2012-13 & 2013-14**

11. This PrI is necessary, because under an integrated treasury management strategy (in accordance with best practice under the CIPFA Code of Practice on Treasury Management in the Public Services), borrowing is not associated with particular items or types of expenditure, whether revenue or capital.

	<b>2009-10 Actual £ million</b>	<b>2010-11 Expected £ million</b>	<b>2011-12 Estimate £ million</b>	<b>2012-13 Estimate £ million</b>	<b>2013-14 Estimate £ million</b>
Capital Financing Requirement	299.5	320.5	373.0	413.0	416.4
Net Borrowing	142.6	175.2	215.2	255.2	275.2
<b>CFR not funded by net borrowing</b>	<b>156.9</b>	<b>145.3</b>	<b>157.8</b>	<b>157.8</b>	<b>141.2</b>

12. The increase in the net borrowing figure between 2009-10 and 2010-11 results from a fall in the level of investments held due to increased spending. In the following financial years, 2011-12 to 2013-14, net borrowing is expected to increase as planned additional long term borrowing is taken out.
13. No problems are foreseen in meeting the “Golden Rule” over the period under review. The table above shows a significant margin not funded by net borrowing.

PrI 5 – Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services (“The Code”)

14. The Revised CIPFA Code of Practice for Treasury Management in the Public Services 2009 was adopted by Wiltshire Council at its meeting on 23 February 2010.
15. All recommendations within this report are consistent with the Revised CIPFA Code.

**Treasury Management Indicators within the Prudential Code**

TrI 1 – Authorised Limit for External Debt

16. The Authorised Limit is the Operational Boundary (see TrI 2 below), including an allowance for unplanned and irregular cash movements. This allowance is difficult to predict, 15% is proposed for 2011-12 to 2013-14 and this will be kept under review. This allows for the possibility of additional borrowing during the year as a result of Government support for further schemes and provides headroom where the projection proves too optimistic (payments made earlier or receipt of income delayed against that forecast).

<b>Authorised Limit</b>	<b>2011-12 £ million</b>	<b>2012-13 £ million</b>	<b>2013-14 £ million</b>
Borrowing	453.0	499.7	504.6
Other Long Term Liabilities	0.2	0.2	0.2
<b>TOTAL</b>	<b>453.2</b>	<b>499.9</b>	<b>504.8</b>

## Prudential and Treasury Indicators for 2011-12, 2012-13 & 2013-14

17. The Authorised Limit set by the Authority is the statutory borrowing limit under Section 3(1) of the Local Government Act 2003, a breach would be serious and therefore there is the need to build in sufficient headroom.

### Trl 2 – Operational Boundary for External Debt

18. The Operational Boundary and the Authorised Limit are central to the Prudential Code and reflect the limits that authorities place on the amount of their external borrowing.

19. The Operational Boundary is based on a prudent estimate of the most likely maximum level of external borrowing for both capital expenditure and cash flow purposes, which is consistent with other budget proposals. The basis of the calculation for 2011-12 (£393.8 million) is:

- Expected Capital Financing Requirement at 31 March 2011 of £320.5 million
- Plus the expected long-term borrowing to finance capital expenditure (supported borrowing £22.4 million and unsupported £42.1 million)
- Less the expected set-aside for debt repayment (£11.2 million)
- Plus the expected maximum level of short-term cash flow borrowing that is anticipated (£20.0 million).

<b>Operational Boundary</b>	<b>2011-12 £ million</b>	<b>2012-13 £ million</b>	<b>2013-14 £ million</b>
Borrowing	393.8	434.5	438.8
Other Long Term Liabilities	0.2	0.2	0.2
<b>TOTAL</b>	<b>394.0</b>	<b>434.7</b>	<b>439.0</b>

20. The Operational Boundary for each year also includes a small provision for other long term liabilities.

21. The Operational Boundary is a key management tool for monitoring the Authority's expected level of borrowing. It is essential to ensure that borrowing remains within the limits set and to take appropriate action where any likely breach is anticipated. Monitoring will take place through the year and will be reported to Cabinet.

### Trl 3 – External Debt – Actuals at 31 March 2010 and Expected 2011

22. This Trl shows the amount of gross external debt outstanding in periods prior to the budget years under consideration. Other long term liabilities relate to finance leases on certain properties, plant, vehicles and equipment. It should be noted that as these figures are taken at a point in time, they are not comparable with the Authorised Limit and Operational Boundary, which are control limits.

	<b>31/3/10 Actual £ million</b>	<b>31/3/11 Expected £ million</b>
Borrowing	205.2	205.2
Other Long Term Liabilities	0.2	0.2
<b>TOTAL</b>	<b>205.4</b>	<b>205.4</b>

## Prudential and Treasury Indicators for 2011-12, 2012-13 &amp; 2013-14

**Treasury Management Indicators within the Treasury Management Code****Trl 4a and 4b – Upper Limit on Fixed Interest Rate Exposures and Variable Interest Rate Exposures, respectively**

23. Future interest rates are difficult to predict. Anticipated rates are shown in the main report, under Risk Assessment. Indications are that best value will be achieved by taking long-term loans at fixed rates in 2011-12. However, consideration of short term variable rate loans may prove to be advantageous, in 2011-12 and in future financial years.
24. Interest rates will be monitored closely, in conjunction with the treasury adviser, to take advantage of any favourable changes in circumstances. The strategy should still be flexible, the upper limit for fixed interest rate and variable interest rate exposures are set out below.

**The Council's upper limit for fixed interest rate exposure for the three year period 2011-12 to 2013-14 is 100% of net outstanding principal sums.**

**The Council's upper limit for variable interest rate exposure is 20% for 2011-12, 30% for 2012-13 and 35% for 2013-14 of net outstanding principal sums.**

**Trl 5 – Upper & Lower Limits on the Maturity Structure of Borrowing**

25. The Council's policy needs to ensure that it is not forced to refinance too much of its long term debt in any year when interest rates are high. The present long-term debt of £205.2 million (as at 4 January 2011) falls due for repayment over the next 60 years. LOBO (Lender Option Borrower Option) market loans are included at rates based upon their appropriate 'contractual lives', as recommended by CIPFA. Most of the Council's debt is, therefore, reported as maturing within the period "10 years and above".
26. In addition to the main maturity indicators it is considered prudent that no more than 15% of long term loans should fall due for repayment within any one financial year. The actual maximum percentage falling due for repayment in any one year is currently 6.3% (£13 million in both 2052-53 and 2053-54). The average interest rate on present long-term debt is 4.325%, which, according to the latest available information, is one of the lowest local authority rates.
27. In order to protect the Council from this risk and to safeguard the continuity in treasury management financing costs, the following limits have been adopted.

<b>Limits on the Maturity Structure of Borrowing</b>	<b>Upper Limit</b>	<b>Lower Limit</b>
Maturing Period:		
- under 12 months	15%	0%
- 12 months and within 24 months	15%	0%
- 2 years and within 5 years	45%	0%
- 5 years and within 10 years	75%	0%
- 10 years and above	100%	0%

**Prudential and Treasury Indicators for 2011-12, 2012-13 & 2013-14**

Trl 6 – Principal Sums invested for periods of longer than 364 days

28. This Trl is covered by the Annual Investment Strategy, which is detailed in the following appendix.

**WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2011-12**

**The Main Strategy**

1. The Council will have regard to the Department for Communities and Local Government's (DCLG's) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The general investment policy of the Council is the prudent investment of any surplus cash balances, the priorities of which are:
  - a) the security of capital and
  - b) the liquidity of investments.
2. The Council will also aim to achieve the optimum return on investments commensurate with high levels of security and liquidity. The risk appetite of this Council is low in order to give priority to the security of its investments.
3. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.
4. All Council investments will be in sterling. This will avoid foreign exchange rate risk.
5. Investment of the Council's normal cash flow requirements will be in specified investments, as prescribed in "The Guidance". The categories of organisations with whom investments will be placed and the minimum high credit ratings required for each category are those set out in the minimum requirements for high credit rating below.
6. Investments in money market funds may be made if the fund has a high credit rating (AAA), as prescribed in the minimum requirements for high credit rating below.
7. In addition, using the professional judgement of the Council's treasury advisers, non specified investments may be made in UK Government Bonds (Gilts) and in multilateral development banks (as defined in Statutory Instrument 2004 No. 534) with a high credit rating, as prescribed in the minimum requirements for high credit rating below.
8. Such investments are the only non-specified investments authorised for use and will only be:
  - a) in sterling
  - b) in the case of UK Gilts, for a maximum of 50 years; and
  - c) for investments maturing in excess of 12 months, limited to £30 million.
9. For specified investments made under the recommendations of the Council's treasury adviser, the approved policy must be followed and is bound by the minimum requirements for high credit rating below.



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10. The Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1 January 2010, and will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 393.
11. The Council uses the creditworthiness service provided by its treasury adviser. This service has been progressively enhanced over the last year and now uses a sophisticated modelling approach, with credit ratings from all three rating agencies – Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as ‘overlays’:
  - a) credit watches (typically resolved over a relatively short period) and credit outlooks (indicates the direction a rating is likely to move over a one to two-year period) from credit rating agencies;
  - b) CDS spreads to give early warning of likely changes in credit ratings; and
  - c) sovereign ratings to select counterparties from only the most creditworthy countries
12. This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.
13. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within the weekly credit list of worldwide potential counterparties provided by the Council’s treasury advisers. The Council, where it is considered appropriate and in line with its whole investment strategy, will therefore use counterparties within the following durational bands:
  - a) Yellow – 5 years (a new category introduced by the treasury advisers late in 2010 to cover AAA rated Government debt or its equivalent, including a new investment instrument – collateralised deposits, where the investment is secured only against local authority debt, namely LOBOs, making them effectively government exposure);
  - b) Purple – 2 years;
  - c) Blue – 1 year (only applies to nationalised or semi nationalised UK Banks and their subsidiaries);
  - d) Orange – 1 year;
  - e) Red – 6 months;

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- f) Green – 3 months; and
  - g) No Colour – not to be used.
14. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moodys tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The creditworthiness service does though, use ratings from all three agencies, but by using a scoring system, does not give undue prevalence to just one agency's ratings.
15. All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the treasury advisers creditworthiness service. Following receipt of this information:
- a) any financial institutions meeting the criteria are updated on the list of authorised lenders and investments may then be placed with “qualifying” institutions immediately;
  - b) if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately;
  - c) if funds are held by an institution that subsequently falls outside the current credit rating criteria and CDS overlay, all funds will be withdrawn from that institution at the earliest opportunity. This will normally be on the maturity of that deposit. If the fall is significant and there are more than three months before the maturity date and in any other extreme circumstances, negotiations for premature repayment will be pursued;
  - d) whenever there is a change in the list of authorised lenders, a revised list will be provided to those authorised to deal in investments on behalf of the Council, including its authorised brokers.
  - e) in addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
16. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.
17. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings.

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**The Minimum requirements for “high credit rating”**

18. In accordance with the DCLG Guidance on Local Government Investments in respect of selection of counterparties with whom investments are placed, Wiltshire Council will comply with the minimum requirements below.
19. Credit ratings will be those issued by Fitch Ratings Ltd in respect of individual financial institutions (as shown below, where F1+ is the highest short term rating and AAA the highest long term rating). An exception is made in respect of money market funds, as shown below, where a different overall AAA rating is the highest.
20. The minimum requirements for high credit rating, by type of institution, are as follows:
  - **Banks incorporated inside the United Kingdom with a short term credit rating of at least F1 or Government backed and their subsidiaries;**
  - **Banks incorporated outside the United Kingdom with a short term credit rating of at least F1+ and a long term rating of A+;**
  - **United Kingdom building societies with a short term credit rating of at least F1 or Government backed;**
  - **All local authorities and public bodies (as defined in S23 of the Local Authorities Act 2003) (ratings are not issued for these bodies);**
  - **Multilateral development banks (as defined in Statutory Instrument 2004 No. 534) with a short term credit rating of at least F1 and long term credit rating of AAA;**
  - **All banks & building societies must have an individual rating of at least C;**
  - **In addition, all banks and building societies to which the Authority may lend funds must have a support rating of no more than 3 (1 being the highest support rating);**
  - **Money market funds, which have been awarded the highest possible rating (AAA) from at least one of the following credit rating agencies, Standard and Poor’s, Moody’s Investor Services Ltd or Fitch Ratings Ltd.; and**
  - **Deposits must only be placed in money market funds subject to individual signed management agreements.**

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21. In addition to the above criteria, the following limits will be applied to the total cumulative investments placed with an individual institution (or group of institutions where there is common ownership):

**a) Up to £15 million:**

- **UK incorporated banks with a long term credit rating of at least AA;**
- **Overseas banks that have a long term credit rating of at least AA;**
- **Multilateral development banks;**
- **Local authorities and other public bodies; and**
- **Money market funds.**

**b) Up to £8 million:**

- **Other UK incorporated banks (that have a long term credit rating of less than AA but which also satisfy the credit rating conditions within this Strategy);**
- **Other overseas banks (that have a long term credit rating of less than AA but which also satisfy the credit rating conditions within this Strategy);**
- **UK Building societies with long term credit rating of at least A; and**
- **Government backed UK and overseas banks and UK building societies and their subsidiaries.**

22. The following investment duration matrix shows the maximum duration for which an investment can be placed, depending on the combination of the individual institution's long term, short term, individual and support ratings (e.g. up to five years where an institution is classified as F1+ (short term rating), AAA (long term rating), A (individual rating) and 1 (support rating) or up to one year where an institution is classified as F1, A+, A, 2).

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Investment Duration Matrix

		Ratings			
Short Term	Long Term	Individual	Support		
			1	2	3
F1+	AAA	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA+	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA	A	1-5yrs	1-5yrs	1 yr
		A/B	1-5yrs	1-5yrs	3 mths
		B	1-5yrs	1-5yrs	3 mths
		B/C	1-5yrs	1-5yrs	3 mths
		C	1 yr	1 yr	3 mths
	AA-	A	1-2yrs	1-2yrs	1 yr
		A/B	1-2yrs	1-2yrs	3 mths
		B	1-2yrs	1-2yrs	3 mths
		B/C	1-2yrs	1-2yrs	3 mths
		C	1 yr	1 yr	3 mths
F1	A+	A	1 yr	1 yr	3 mths
		A/B	1 yr	1 yr	3 mths
		B	1 yr	1 yr	3 mths
		B/C	3 mths	3 mths	n/a
		C	3 mths	3 mths	n/a
	A	A	1 yr	1 yr	3 mths
		A/B	1 yr	1 yr	3 mths
		B	1 yr	1 yr	3 mths
		B/C	3 mths	3 mths	n/a
		C	3 mths	3 mths	n/a