

15 February 2012

Subject: Treasury Management Strategy 2012-13

Cabinet Member: Councillor John Brady - Finance, Performance and Risk

Key Decision: No

Executive Summary

This report presents the Treasury Management Strategy for 2012-13 including:

- a) the Prudential and Treasury Indicators (Prls and Trls) for the next three years;
- b) other debt management decisions required for 2012-13 that do not feature within the Prls or Trls; and
- c) the Annual Investment Strategy for 2012-13.

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 and approve the changes in the Strategy, resulting from the replacement of Fitch Ratings individual credit ratings with new bank viability ratings (Appendix B, paragraph 22) and the updated guidance on the determination of the maturity of LOBO loans (a detailed explanation is shown below in paragraphs 21 to 24 of this report);
- 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

To enable the Council to agree a Treasury Management Strategy for 2012-13 and set Prudential Indicators that comply with statutory guidance and reflect best practice.

**Michael Hudson
Chief Finance Officer**

15 February 2012

Subject: Treasury Management Strategy 2012-13

Cabinet Member: Councillor John Brady - Finance, Performance and Risk

Key Decision: No

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 2012-13, incorporating changes in respect of credit ratings (Fitch's new bank viability rating) and the determination of the maturity of LOBO loans.

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.

Main Considerations for the Cabinet

Revised Prudential Indicators (PrIs) and Treasury Indicators (TrIs)

Basis of the Indicators

3. A summary of the revised PrIs and TrIs is shown in Appendix A. The key indicators are the Treasury Indicators relating to the Authorised Limit (TrI 1) and the Operational Boundary (TrI 2), which control the Council's exposure to debt.
4. The PrIs and TrIs have been set on the basis of all known commitments and the effect of all known revenue and capital proposals relating to the council.

Monitoring and Reporting of the Prudential Indicators

5. Progress will be monitored against the PrIs and TrIs 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 bi-monthly capital monitoring reports and an Interim Report on Treasury Management Strategy for 2012-13 in November 2012. Cabinet will also receive regular treasury reports.
6. 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 unusual cash movements, for example, and should not be breached.

Borrowing Strategy

Levels

7. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded (please refer to Appendix A – paragraph 11) with loan debt as cash supporting the Council's reserves, balances and cash flow have been used as a temporary measure. This strategy is prudent, as investment returns are low and counterparty risk is high, and will be maintained for the borrowing excluding the HRA reform settlement.
8. Against this background and the risks within the economic forecast, caution will be adopted with the 2012/13 treasury operations. Interest rates in financial markets will be monitored and a pragmatic approach adopted, to changing circumstances:
 - a) if it was felt that there was a significant risk of a sharp **fall** in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
 - b) if it was felt that there was a significant risk of a much sharper **rise** in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

HRA

9. The requirement for the HRA reform settlement to be made to the DCLG on 28 March 2012 will require a separate consideration of a borrowing strategy. The Council will need to have the cash settlement amount of £119.4 million available by the 28th March 2012, so separate borrowing solely for this purpose is anticipated. The PWLB are providing loans at interest rates 0.85% lower than the normal PWLB interest rates solely for the settlement requirements. This provides a compelling option to utilise this borrowing availability. The exact structure of debt to be drawn is currently being considered by officers to ensure it meets the requirements of the HRA business plan and the overall requirements of the Council. Whilst the debt can be drawn earlier than needed, this may incur a revenue cost, and will be

considered when a review of the structure of actual prevailing borrowing and investment interest rates is undertaken nearer to the time.

10. The final debt structure and the actions taken following the review will be reported to members at the next available opportunity.

Rate and Timing of Borrowing

11. Taking account of the cash required to support the capital programme over the medium term, the Council has a requirement, subject to the approval of the capital programme on 28th February 2012, to borrow an additional £116 million between now and the end of 2014-15. This is reflected in Prl 4 in Appendix A (Net Borrowing – General Fund), i.e. the increase in net borrowing of £291.2 million in 2014-15 less £163.1 million in 2010-11, less the underlying decrease in investments of £12.1 million.
12. The timing of any borrowing is crucial in terms of interest rates and the potential to minimise interest costs. Prior to any actual borrowing the treasury team will, in conjunction with our treasury advisers, proactively manage the interest rate position, using all information available to inform the borrowing decision.
13. It is, of course, not always possible to obtain the lowest rates of interest, as there is a risk that unforeseen events can significantly alter the level of rates, however, ongoing active monitoring of rates will mitigate against this risk.
14. In supporting the capital programme, the Council will consider all borrowing options, such as:
 - a) internal borrowing, which is the cheapest form of borrowing, using medium term cash balances;
 - b) fixed rate PWLB borrowing;
 - c) long term fixed rate market loans at rates, which can be significantly below PWLB rates for the equivalent maturity period (where available).
15. Whilst maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

Other Debt Management Issues

Policy on Borrowing in Advance of Need

16. 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Debt Rescheduling

17. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential 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 current treasury position and the size of the cost of debt repayment (premiums incurred).
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 treasury strategy;
 - 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 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 members at the earliest meeting following its action.

Lender Option Borrower Option (LOBO) Market Loans

21. Wiltshire Council currently has borrowings of £61 million in LOBO loans.
22. 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 'secondary 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.
23. If the lender exercises his option to revise the interest rate at one of the 'call option dates', the Council's strategy is that it 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.
24. There has been a change in guidance (CIPFA – Treasury Management in Public Services Guidance Notes for Local Authorities, 2011 Edition) relating to the determination of the maturity of borrowing that affects the date on which a LOBO loan should be treated as maturing. Previous guidance was that the date of maturity of LOBO loans should be based on their appropriate

“contractual lives”, this has been changed and the date of maturity should now be referenced to the earliest date on which the lender can require payment. Guidance states that “if the lender has the right to increase the interest rate payable without limit, such as in a LOBO loan, this should be treated as a right to require payment.” This has made it necessary to amend the relevant treasury management indicator (Trl 5 – Appendix A, paragraph 26).

Short Term Cash Deficits

25. 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

26. The Annual Investment Strategy for 2012-13, which sets out the policy framework for the investment of cash balances, is shown in Appendix B. Key issues to note are:
 - a) the risk appetite of this Council is low in order to give priority to the security of its investments;
 - b) 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;
 - c) all Council investments will be in sterling. This will avoid foreign exchange rate risk.
27. The strategy introduces a number of changes in 2012-13, they are:
 - a) the Investment Duration Matrix previously shown and referenced in Appendix B has been removed as it is no longer necessary as the Council uses Sector Treasury Services credit ratings list, which incorporates investment duration limits;
 - b) the replacement, by the Fitch rating agency, of the individual counterparty ratings with new Bank Viability Ratings, which represents Fitches view “as to the intrinsic creditworthiness of a user” and are “designed to be internationally comparable”; and
 - c) the updated guidance on the determination of the maturity of LOBO loans, as explained in paragraphs 21 to 24 above.

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 2012-13 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 start increasing until quarter 3 (June to September) 2013. The Bank Rate is not expected to rise until September 2013.

Icelandic Deposits

33. The position in respect of the £12 million investment that was frozen as a result of the collapse of the Icelandic banks, Heritable (£9 million) and Landsbanki (£3 million) is that the Council has:
- a) received just over £6 million from Heritable, with further repayments expected in 2012; and
 - b) recently received its first distribution, of circa £0.950 million, from Landsbanki Islands hf. Bank, following Iceland's Supreme Court judgement that Councils, amongst other test creditors, have priority status and consequently will be paid first (before unsecured creditors). Distributions from Landsbanki, including the first, will be received in a 'basket of currencies' (GBP, US Dollars, Euros and Icelandic Kroner). It is anticipated that the recovery of all the assets will take some time and may not be concluded until 2016 or later.

34. It is likely that the Council will eventually recover 95% of its original investment in Heritable and 98% of the original investment in Landsbanki Islands hf.

Minimum Revenue Provision

35. 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.
36. In accordance with Local Authorities (Capital Finance and Accounting) Regulations 2008 the council adopted a MRP annual policy in May 2009.
37. For financial year 2011-12 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.
38. It is proposed that this policy is retained in 2012-13.

Environmental and Climate Change Considerations

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

Equalities Impact of the Proposal

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

Risk Assessment and Financial Implications

41. 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).
42. The strategies in Appendix A and Appendix 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.
43. 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).
44. With the borrowing required for HRA self-financing, the Council's treasury portfolio has an increased proportion of debt to investments.

45. Interest earnings are an important source of revenue for the Council and it is, therefore, important that the portfolio is managed in a way that maximises the investment income stream, whilst managing exposure to risk and maintaining sufficient liquidity.

Legal Implications

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

Options Considered

47. Future consideration will be given to alternative borrowing and investment options to improve the cost effectiveness of and return on treasury activities for the Council. This may incorporate consideration of alternative sources of capital financing, such as the issuing of bonds, rather than the more traditional borrowing approaches, together with longer term investments, where appropriate and subject to security and liquidity of investments.
48. The options in relation to the revenue and capital budgets in these proposals are fully consistent with the figures included within the budget considerations.

Conclusion

49. The Cabinet is requested to recommend that the Council:
- a) adopt the Prudential and Treasury Indicators (Appendix A);
 - b) adopt the Annual Investment Strategy and approve the changes in the Strategy, resulting from the replacement of Fitch Ratings individual credit ratings with new viability ratings (Appendix B, paragraph 22) and the updated guidance on the determination of the maturity of LOBO loans (paragraphs 21 to 24 of this report);
 - 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
Chief Finance Officer

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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 2012-13, 2013-14 & 2014-15
Appendix B Annual Investment Strategy for 2012-13

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15

1. 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

2. This Prl shows the actual and anticipated level of capital expenditure for the five years 2010-11 to 2014-15. The years 2013-14 to 2014-15 are not ratified and will be taken to members in the Capital Programme Proposals 2013-14 onwards. This will be submitted to Cabinet and Council in February 2012.

Department	2010-11 Actual £million	2011-12 Expected £million	2012-13 Estimate £million	2013-14 Estimate £million	2014-15 Estimate £million
General Fund	111.3	112.2	113.9	80.4	48.7
Housing Revenue Account	3.3	4.2	9.4	10.2	10.6
Total	114.6	116.4	123.3	90.6	59.3

3. 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.

Prl 2 – Ratio of Financing Costs to Net Revenue Stream

4. Prl 2 identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream (funding receivable from the Government and council tax payers and rents receivable in the case of the HRA).

	2010-11 Actual £million	2011-12 Expected £million	2012-13 Estimate £million	2013-14 Estimate £million	2014-15 Estimate £million
General Fund	5.8%	6.8%	8.2%	9.0%	4.5%
Housing Revenue Account	0.7%	0.6%	19.9%	18.7%	17.5%

5. The cost of financing will rise 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. In terms of the rise in HRA financing costs in 2012-13, through 2013-14 and 2014-15, this is due to the change in HRA system. 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.

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15

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 and Housing Rents

7. Prl 3 represents the potential increase in Council Tax/Housing Rents required to fund the planned increase in the capital budgets for the forthcoming year and future years as a proportion of the tax base at Band D/average weekly housing rents. Due to the change to the subsidy system there is no planned effect on average housing rents due to the additional borrowing required.

	2012-13 £	2013-14 £	2014-15 £
Effect on Band D Council Tax	13.98	16.69	10.69
Effect on Average Housing Rent per week	0.00	0.00	0.00

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.
11. This Prl 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.

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15

	2010-11 Actual £million	2011-12 Expected £million	2012-13 Estimate £million	2013-14 Estimate £million	2014-15 Estimate £million
CFR – General Fund	320.4	353.4	389.3	396.4	391.1
CFR – HRA	3.8	123.2	123.2	123.2	123.2
Net Borrowing – Gen Fund	163.1	220.2	268.2	282.2	291.2
Net Borrowing – HRA	0.0	119.4	119.4	119.4	119.4
CFR not funded by net borrowing – Gen Fund	157.3	133.2	121.1	114.2	99.9
CFR not funded by net borrowing - HRA	3.8	3.8	3.8	3.8	3.8

12. The increase in the General Fund net borrowing figure between 2010-11 and 2011-12 results from expected additional borrowing. In the following financial years, 2012-13 to 2014-15, 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.

Pr1 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

Tr1 1 – Authorised Limit for External Debt

16. The Authorised Limit is the Operational Boundary (see Tr1 2 below), including an allowance for unplanned and irregular cash movements. This allowance is difficult to predict and has previously been set at 15%. Having reviewed the position, a more prudent allowance of 2.5% is proposed for General Fund borrowing for 2012-13 to 2014-15. This revised allowance provides 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) and will be kept under review. There is no allowance in respect of HRA borrowing as it is capped and, therefore, cannot be exceeded.

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15

Authorised Limit	2012-13 £million	2013-14 £million	2014-15 £million
Borrowing – General Fund	418.5	417.6	426.8
Borrowing – HRA	123.2	123.2	123.2
Other Long Term Liabilities	0.2	0.2	0.2
TOTAL	541.9	541.0	550.2

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 General Fund borrowing 2012-13 (£408.5 million) is:

- Expected Capital Financing Requirement at 31 March 2012 of £353.6 million
- Plus the expected long-term borrowing to finance capital expenditure (unsupported only £48.2 million)
- Less the expected set-aside for debt repayment (£13.3 million)
- Plus the expected maximum level of short-term cash flow borrowing that is anticipated (£20.0 million).

20. The basis of the calculation for HRA borrowing 2012-13 is the debt settlement of £123.2 million.

Operational Boundary	2012-13 £million	2013-14 £million	2014-15 £million
Borrowing	408.5	407.6	416.5
Borrowing – HRA	123.2	123.2	123.2
Other Long Term Liabilities	0.2	0.2	0.2
TOTAL	531.9	531.0	539.9

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

22. 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.

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15Trl 3 – External Debt – Actuals at 31 March 2010 and Expected 2011

23. 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.

	31/3/11 Actual £million	31/3/12 Expected £million
Borrowing – General Fund	245.2	290.2
Borrowing – HRA	0.0	123.6
Other Long Term Liabilities	0.2	0.2
TOTAL	245.4	414.0

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

24. 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 2012-13. However, consideration of short term variable rate loans may prove to be advantageous, in 2012-13 and in future financial years.
25. 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 2012-13 to 2014-15 is 100% of net outstanding principal sums.

The Council's upper limit for variable interest rate exposure is 40% for 2012-13, 40% for 2013-14 and 45% for 2014-15 of net outstanding principal sums.

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

26. 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 £245.2 million (as at 15 December 2011) falls due for repayment over the next 60 years. LOBO (Lender Option Borrower Option) market loans are included at rates determined by reference to the earliest date on which the lender can require payment (i.e. at the next interest rate call date), as currently recommended by CIPFA. Despite this change, most of the Council's debt remains as maturing within the period "10 years and above", albeit PWLB debt only, and it does not make it necessary, at this stage, to increase any of the upper limits. Depending on the maturity profile, the upper limits may require amendment for further borrowing in the future.

Prudential and Treasury Indicators for 2012-13, 2013-14 & 2014-15

27. 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.

28. 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.

Limits on the Maturity Structure of Borrowing	Upper	Lower Limit
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%

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

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

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2012-13

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 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").
2. 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.
3. 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.
4. 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.
5. All Council investments will be in sterling. This will avoid foreign exchange rate risk.
6. 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.
7. 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.
8. 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.
9. 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.
10. 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.

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2012-13

11. 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. The Pension Fund Investment Strategy is approved by the Pension Fund Committee.
12. The Council applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:
 - a) credit watches and credit outlooks from credit rating agencies;
 - b) credit default swap (CDS) spreads, which basically give early warning of likely changes in credit ratings; and
 - c) sovereign ratings to select counterparties from only the most creditworthy countries.
13. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council 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;
 - f) Green – 3 months; and
 - g) No Colour – not to be used.
14. This methodology does not apply the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2012-13

15. All credit ratings will be monitored at least weekly (daily if there are any updates released by Sector). The Council is alerted to changes in ratings of all three agencies through its use of the Sector creditworthiness service.
16. 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.
17. In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swaps 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.
18. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.
19. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings.

The Minimum requirements for "high credit rating"

20. 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.
21. 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.
22. 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 most of these bodies);**

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2012-13

- **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 a bank viability rating of at least bbb – except where the counterparty is UK Government backed (fully and partially) – (aaa being the highest, through aa, a and bbb (Please note that Fitch Ratings recently (November 2011) introduced a ‘Viability Rating’, which is designed to be internationally comparable and represent Fitch’s view as to the intrinsic creditworthiness of the user. Sector are no longer using the individual ratings, which have been replaced by the viability ratings);**
 - **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.**
23. 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);**

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2012-13

- **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.**