IMPLEMENTATION EXECUTIVE
11 FEBRUARY 2009

AMENDMENT TO APPENDIX B

OF THE TREASURY MANAGEMENT STRATEGY 2009-10

Executive Summary

Members are being asked under Item VII of the Budget Booklet, "Treasury Management Strategy 2009-10" to agree the Council's approved lending list by adopting the Annual Investment Strategy as set out in Appendix B of that report.

Given the recent downgrading of a number of banks previously on the council's approved lending list it has been necessary to review the Annual Investment Strategy proposed for 2009-10 for Wiltshire Council. This will ensure there are sufficient facilities in place to make deposits and ensure counterparty limits are not exceeded.

Proposal

The Implementation Executive is asked to recommend that the County Council substitute the amended Annual Investment Strategy attached to this report ("Budget Booklet Item VII Revised Appendix B") for the original Appendix B of Item VII of the Budget Booklet and adopt it as the annual investment strategy for 2009-10.

Reasons For Proposals

To ensure there are sufficient facilities in place to make deposits and ensure counterparty limits are not exceeded.

Sandra Farrington
Chief Financial Officer

AMENDMENT TO APPENDIX B

OF THE TREASURY MANAGEMENT STRATEGY 2009-10

Purpose of Report

1. Given the recent downgrading of a number of banks previously on the authorities lending list it has been necessary to review the Annual Investment Strategy proposed for 2009-10 for Wiltshire Council. This will ensure there are sufficient facilities in place to make deposits and ensure counterparty limits are not exceeded.

Main Considerations for the Implementation Executive

Update on Activity Within the Proposed Strategy

2. Officers have recently met with Sector (the authorities Investment Advisors) to discuss a number of alternative options along with the option of repaying debt. All the options currently fall within the proposed strategy for 2009-10. Some of the options have not previously been pursued by the Council.

3. The Debt Management Office (DMO) is an executive agency of Her Majesty's Treasury and offers a facility for Local Authorities to place deposits. Due to the recent Icelandic banking crisis and the inflow of cash to them from Local Authorities the DMO are predicting significant delays in opening new accounts but this will be pursued for the future.

4. Money Market Funds (MMF) - MMF are currently included in the authority's current investment strategy however no accounts have been opened to date.

   There are basically two types of MMF's.

   i) MMF's that invest in term deposits with other financial institutions
   ii) MMF's that invest in government backed securities such as gilts, treasury bills and supernationals

5. This is currently a growing market and offers a workable solution for the authority. Sector will forward contact details to invite providers in for presentations. Barclays and Northern Trust are two of the names in the market. MMF that invest in term deposits restrict their investments to 10% for each counterparty to ensure the fund is diversified and low risk.

   The fund to look for should be MR1+ rated. Sector suggested we open a number of MMFs.

6. Call Accounts – Sector recommended opening a few more call accounts. Officers are pursuing this option and have collated the necessary forms to complete. The call accounts will be opened with institutions currently on the agreed lending list.

7. Repayment of Debt - A number of options were presented by Sector for the repayment of debt. The most attractive of these options was repayment of £9.5m of Public Works Loan Board debt at coupon rate of 4.577%. This would create an annual interest saving of £291,000 which would offset lost interest on investments.

8. When considering this option a view of future refinancing cost would need to be looked at. As the authority would be repaying debt at a relatively low rate and future debt may be more expensive and this would feed through to future council tax increases.

Amendments to the Proposed Annual Investment Strategy

9. In addition to pursuing the options noted above, two further changes to the Annual Investment Strategy are recommended in light of recent market changes and the downgrading of the ratings given to some major UK banks.

10. The first proposal is to change the lending criteria for limits up to £15m to AA- from AA for UK incorporated banks (Investment strategy paragraph 14a). This would not change the number of institutional the authority could invest with, it would just increase the limit for those banks recently downgraded to an £8m limit such as Lloyds, Bank of Scotland and Barclays.

11. The second recommendation recognises the move towards nationalised banks. Given the gradual creep to nationalisation, the Council is asked to incorporate this unusual but relevant scenario into the Annual Investment Strategy as it is possible that this may become a continuing theme over the next year and the credit policy needs to be flexible to cater for this. Officers propose the insertion of the following paragraphs which would enable Royal Bank of Scotland plc and National Westminster plc to be included in the lending list.

    Fully nationalised banks *in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks of high credit worthiness. In particular, as they are no longer separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being* *made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.*

The other situation that could arise is where the Bank hasn't been fully nationalised but receives substantial support (greater than 50% ownership) from the UK Government, in which case the individual rating is E i.e. the Fitch definition is "A bank which requires external support." Both such situations will be recognised so that the banks in question will be deemed suitable for investment under the Annual Investment Strategy.

12. The above changes have been made to the proposed Annual Investment Strategy and a revised Appendix B is attached which Members are asked to approve.

Environmental Impact of the Proposals

13. None have been identified.

Equalities Impact of the Proposal

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

Risk Assessment

15. As mentioned in the Treasury Management Strategy one of the risks to which the Council is exposed to is the credit risk of its investments. By keeping investments short term, diversifying them by using different counterparties and restricting the maximum investment per counterparty this should ensure this risk is kept to a minimum.

Financial Implications

16. The financial implications of the strategies discussed in this report are fully reflected within the revenue and capital budget figures included elsewhere on this agenda.

Reasons for Proposal

17. The proposals are recommended to ensure there are sufficient facilities in place to make deposits and ensure counterparty limits are not exceeded

Report Author: Catherine Lee

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

WILTSHIRE COUNCIL- ANNUAL INVESTMENT STRATEGY FOR 2009-10

The Main Strategy

1. 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.

3. The Council will not borrow purely to invest or lend-on specifically to make a return.

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 Department for Communities and Local Government's (DCLG) Guidance on Local Government Investments ("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, as prescribed in the minimum requirements for high credit rating below.

7. In addition, using Sector's professional judgement, 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 Sector recommendations, the approved policy must be followed and is bound by the minimum requirements for high credit rating below.

10. Credit ratings are maintained and monitored monthly against ratings issued by Fitch Ratings Ltd. Following receipt of these ratings from Sector:

   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 funds are held by an institution that subsequently falls outside the revised credit rating criteria, 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, negotiations for premature repayment will be pursued;

c) 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.

11. Fully nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks of high credit worthiness. In particular, as they are no longer separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

The other situation that could arise is where the Bank hasn't been fully nationalised but receives substantial support (greater than 50% ownership) from the UK Government, in which case the individual rating is E i.e. the Fitch definition is "A bank which requires external support." Both such situations will be recognised so that the banks in question will be deemed suitable for investment under the Annual Investment Strategy.

<u>The Minimum requirements for "high credit rating"</u>

12. In accordance with the DCLG Guidance on Local Government Investments in respect of selection of counterparties with whom investments are placed, Wiltshire County Council will comply with the minimum requirements below.

13. 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.

14. 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;**

- **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 and Irish (Eire) building societies with a short term credit rating of at least F1 or Government backed;**

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- **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;**
- **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.**

15. 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 satisfy the credit rating conditions in this appendix);**
- **Other overseas banks (that have a long term credit rating of less than AA but satisfy the credit rating conditions in this appendix); and**
- **Building societies with long term credit rating of at least A.**

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- **Government backed UK and overseas banks and building societies**

16. 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).

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