Title of Report:	**Local Government Act 2003 – Borrowing Limits and Annual Investment Strategy 2011/12**
Report to be considered by:	Executive
Date of Meeting:	17 February 2011
Forward Plan Ref:	C2180

Purpose of Report:

In compliance with The Local Government Act 2003, this report summarises the Council's borrowing limits as set out by CIPFA's Prudential Code, and recommends the Annual Investment Strategy for the coming year.

Recommended Action:

To recommend the Annual Investment Strategy as detailed in Section 3 of this report to Council for 2011/12.

Reason for decision to be taken:	Formulation of Treasury Management Policy
Other options considered:	Not applicable
Key background documentation:	None

The proposals will also help achieve the following Council Plan Theme:

☒ **CPT13 - Value for Money**

The proposals contained in this report will help to achieve the above Council Plan Priorities and Themes by:
It forms part of the Council's Budget Framework

Portfolio Member Details	
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Date Portfolio Member agreed report:	03 February 2011

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Implications

Policy:	The formulation of the Treasury Management Strategy for the forthcoming financial year in accordance with the Local Government Act 2003, CIPFA's Prudential Code, and CIPFA's Code of Practice for Treasury Management.
Financial:	Investment Income and Debt Charges form part of the Council's MTFS.
Personnel:	None.
Legal/Procurement:	None.
Property:	None.
Risk Management:	All investments are undertaken with a view to minimisng risk and exposure to loss. The policy sets parameters to ensure this..
Equalities Impact Assessment:	Not required.

Is this item subject to call-in?	Yes: ☐	No: ☒

If not subject to call-in please put a cross in the appropriate box:

The item is due to be referred to Council for final approval	☒
Delays in implementation could have serious financial implications for the Council	☐
Delays in implementation could compromise the Council's position	☐
Considered or reviewed by Overview and Scrutiny Commission or associated Task Groups within preceding six months	☐
Item is Urgent Key Decision	☐

Executive Summary

1. INTRODUCTION

1.1 This report sets out the framework within which the Treasury Team will conduct the council's investments and borrowing for the forthcoming financial year.

1.2 This report is also closely linked to the reports on the Medium Term Financial Strategy (MTFS) and the Capital Strategy and Programme also on this agenda, as it reflects the amount which the Council can afford to borrow to fund its Council's will need to borrow to fund its Capital Programme from 2011/12 onwards.

2. PROPOSALS

2.1 Section 2 of the main report proposes prudential limits for 2011/12 for the ***Authorised Limit for External Debt*** (the maximum amount the Council may borrow at any point in the year) and the ***Operational Boundary for External debt*** (the most money the council would normally borrow at any time during the year). These limits are determined by the amount which the Council needs, and can afford to borrow to fund any planned capital investment which is not funded from government grant, capital receipts, section 106 contributions etc.

2.2 It is proposed to increase these limits approximately £10 million in 2011/12 and £6 million from 2012/13 onwards. These are significantly smaller increases than in recent years. This reflects the constraints on the Council's revenue resources and the increase in Public Works and Loans Board (PWLB) lending rates, both as a result of the Comprehensive Spending Review. Both of these factors mean that the Council can afford to fund a significantly smaller amount of capital spending from borrowing from 2011/12 onwards. (This is explained more fully in the reports on the MTFS and the Capital Strategy and Programme also on this agenda).

2.3 The report also sets prudential limits for ***Exposure to Borrowing at Variable Rate of Interest***, ***Exposure to Borrowing at Fixed Rate of Interest*** and ***Maturity Structure of Borrowing***. It also sets parameters for the types and minimum credit ratings of institutions with which the Council will invest its funds. This element of the policy is designed to maximise investment potential whilst keeping the risk in the Investment Portfolio to its minimum level .

3. CONCLUSION

3.1 These proposals form part of the Council's overall Treasury and Capital Strategy and are aligned with the requirements of the Prudential Code. The strategy sets the underlying principles by which the Council's annual investment and borrowing activity will be managed for the 2011/12 financial year.

3.2 The policy agreed for 2010/11, combined with the management of the investment portfolio, has again proved successful during the current financial year. The economic climate and low interest rates have once more resulted in a lower level of income from the exceptionally high levels prior to 2009/10. However through the application of the policy and the expertise of the Treasury Team the Council has continued to earn a rate of return significantly above base rates.

Executive Report

1. INTRODUCTION

1.1 The Local Government Act 2003 specifies that, before the start of each financial year a local authority shall draw up an Annual Investment Strategy for the forthcoming financial year which it may vary at any time. The strategy and any variations are to be approved by full Council and are to be made available to the public. This report recommends an Annual Investment Strategy for 2011/12.

1.2 West Berkshire Council defines its treasury management activities as: “The management of the organisation’s cash flow, banking, money market transactions, loans and investments, aiming to maximise the return on the Council’s investments while minimising the risks to the Council’s resources.

1.3 West Berkshire Council regards the successful identification, monitoring and control of risk to be the most important measure of the effectiveness of its treasury management activities. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation. All investment and borrowing decisions are governed by the following principles (and in the order shown):

- Security
- Liquidity
- Yield (Return on Investment)

1.4 West Berkshire Council acknowledges that effective treasury management will provide support towards the achievement of its service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2. THE PRUDENTIAL CODE

2.1 The Local Government Act 2003 introduced the new Prudential Capital Finance System, which was applied from 1 April 2004, and replaced the requirements under the Local Government and Housing Act 1989. CIPFA published the final Prudential Code in November 2003, which sets out a range of indicators that the Council must set in order to establish its borrowing limit.

2.2 The following prudential limits are required to be set for the forthcoming financial year and the following two financial years:

- Authorised limit for total external debt - the Maximum amount the Council may borrow at any point in the year.
- Operational boundary for its total external debt - The most money the Council would normally borrow at any time during the year.
- Exposure to borrowing at variable rates of interest.
- Exposure to borrowing at fixed rates of interest.
- Maturity structure of borrowing.

- The Prudential Borrowing Code also impact on the Council's Capital Strategy & Programme 2011/12 – 2015/16, also on this agenda.
- Recommended Prudential Limits for 2010/11

Levels of External Debt

2.3 An annual increase in borrowing is usually required to fund capital expenditure which cannot be funded from grants, capital receipts or other sources of funds. The amount of the increase is determined by the amount of debt charges which the Council can afford to fund from its revenue budget (the Minimum Revenue Provision - MRP). As explained in the reports on the Medium Term Financial Strategy and the Capital Strategy and Programme, also on this agenda, the MRP for 2011/12 to 2013/14 has reduced from the level anticipated at the start of the current financial year, because of a reduction in the Council's revenue funding.

2.4 The limits for external debt which are now recommended for 2011/12 and the following two financial years are shown below in comparison with the level for 2010/11 and the levels which were originally recommended for the next two years in March 2010. These include the current balance of the ex-Berkshire County Council Debt (standing at approximately £21 million). These figures also reflect the need to finance the Capital Programme through Prudential Borrowing and use of Capital Receipts:

Authorised Limit for External Debt		
	As recommended in March 2010	**New recommended Limits**
2010/11	£110 million	£110 million
2011/12	£125 million	£120 million
2012/13	£140 million	£127 million
2013/14	N/A	£133 million

Operational Boundary for External Debt		
	As recommended in March 2010	**New recommended Limits**
2010/11	£100 million	£100 million
2011/12	£115 million	£110 million
2012/13	£130 million	£117 million
2013/14	N/A	£123 million

Other Prudential Limits

2.5 The recommended limits for exposure to borrowing at Variable and fixed rates of interest are as follows (unchanged from 2010/11):

Exposure to Variable Interest Rates	
	Upper Limit
2011/12	50%
2012/13	50%
2013/14	50%

Exposure to Fixed interest rates		
	Upper Limit	**Lower Limit**
2011/12	100%	50%
2012/13	100%	50%
2013/14	100%	50%

2.6 The recommended limits for the maturity structure of borrowing are as follows (unchanged from 2010/11):

	Lower Limit	Upper Limit
Under 1 Year	0%	50%
1 – 2 years	0%	50%
2 – 5 years	0%	50%
5 – 10 years	0%	50%
Over 10 years	0%	90%

3. ANNUAL INVESTMENT STRATEGY FOR 2011/12

3.1 The purpose of the Annual Investment Strategy is to set out the policies for giving priority to the security and liquidity of the Council's investments. The strategy deals with the credit ratings defined for each category of specified investments, the prudential use of non specified investments, and the liquidity of investments.

Specified Investments

3.2 Specified Investments are defined as those satisfying each of the following conditions:

- Denominated in sterling.
- To be repaid or redeemed within 12 months of the date on which the investment was made.
- Do not involve the acquisition of share capital or loan capital in any body corporate.
- Are made with the UK Government, local authorities, parish councils, community councils, or with a deposit taker which has been awarded a high credit rating by a credit rating agency and is authorised by a regulatory body. This body will normally be the Financial Services Authority (FSA), which can be checked at www.fsa.gov.uk/register.

3.3 Any investments that do not meet the criteria defined in paragraph 3.2 above are classified as 'Non-specified Investments'. It is proposed that the Council will only invest in non-specified investments, including those to be repaid or redeemed more than 12 months from the date on which the investment was made, should the need arise in relation to cash-flow and borrowing strategy decisions.

Credit Ratings

3.4 The credit ratings and limits proposed for the categories of investments intended for use by the Council in 2011/12 are as follows:

Debt Management Office (UK Govt)	Unlimited
Local Authorities	Not more than £5,000,000 per authority
Building Societies [1]	
Ranked 1 to 11	Not more than £5,000,000 per institution
Ranked 12 to 22	Not more than £4,000,000 per institution
Ranked 23 to 30	Not more than £3,000,000 per institution
Ranked 31 to 43	Not more than £2,000,000 per institution
Ranked 44 to 51	Not more than £1,500,000 per institution
Ranked 52 to 57	Not more than £1,000,000 per institution
Banks & Other Financial Institutions [2] (rated F1 by Fitch)	Not more than £5,000,000 per institution
Banks & Other Financial Institutions (rated F2 by Fitch)	Not more than £2,500,000 per institution
Money Market Funds (AAA rated)	Not more than £5,000,000 per fund

3.5 These limits, which are unchanged from 2010/11, allow the Treasury Management Group the freedom to maximise investment potential whilst keeping the risk in the Investment Portfolio to its minimum level (essentially risk-free).

3.6 The limits above represent the maximum amounts to be invested with individual organisations. In light of the current financial climate, the Treasury Management Group may temporarily reduce these amounts and/or shorten the time-period of investments in order to spread the exposure to loss from institutions failing. This may well have an impact upon the level of returns. Current policy is to invest with UK institutions with Government backing or Building Societies with sufficient asset base to cover their liabilities (mutual societies).

Liquidity of Investments

3.7 The maximum period for which funds may prudently be committed is 12 months, unless sufficient funds become available, and market conditions are favourable enough to permit secure longer term investment, offering a better rate of return, whilst remaining within the provisions of the Treasury Management Policies.

3.8 The minimum amount to be held during the financial year in investments other than long-term investments is to be 60% (at the point of investment) of the Council's overall investments.

4. BORROWING STRATEGY

4.1 Although no new long term loans have yet been taken out during 2010/11, it will be necessary, before the end of the financial year, to increase the long term debt holdings of the Council. This will be necessary to finance the Council funded element of the 2010/11 capital programme – approximately £15 million. This will

[1] Building Society rankings are checked annually with the Building Societies Association.
[2] Bank and Money Market Fund ratings are checked each month using Fitch credit rating agency.

bring the Council’s long term debt, including the legacy debt from Berkshire County Council, to approximately £62.8 million at 31 March 2010. It is also likely to be necessary to take out new long term loans approximately £9.5 million during 2011/12 to fund the proposed Council funded capital programme for the coming year.

4.2 As in previous years, it will also be necessary on occasions to borrow on a short term basis to cover cash-flow requirements. Short term loans will be arranged with a view to covering cash-flow requirements while minimising the rate and amount of interest paid.

4.3 Although the Bank of England base rate remains at a record low, the Treasury, as part of the comprehensive spending review (CSR), has increased interest rates offered by the Public Works and Loans Board (PWLB) by approximately 1%. This increases the cost of long term borrowing for Local Authorities and is part of the government’s strategy to decrease public sector debt.

4.4 Further consideration, therefore, needs to be given to a longer-term borrowing strategy to enable the Council to support its current and future capital programme. This will be part of the role of the Treasury Management Group in 2011/12 and will include consideration of alternative sources of long term funding including borrowing from institutions other than the PWLB, Tax Increment Funding and local bonds.

5. MONITORING AND REVIEW

5.1 The Treasury Management Group will continue to meet regularly to review the strategy and the performance of the Treasury Management Team. The composition of the Treasury Management Group is unchanged and includes the Portfolio Holder and two other elected members. This is in accordance with the recommendations of the Audit Commission, CIPFA and the Common’s Select Committee reviewing the Local Authority losses with the Icelandic Banks.

5.2 The Treasury Management Group will provide updates in relation to cash-flow and borrowing strategy during the course of the year should the need arise.

Appendices

There are no Appendices to this report.

Consultees

Local Stakeholders: Not consulted

Officers Consulted: Treasury Management Group, Corporate Board

Trade Union: Not consulted