Audit Committee
17 December 2009

Report from the Director of Finance and Corporate Resources

Wards Affected:
ALL

Treasury Management – Department of Communities and Local Government Consultation and current developments

1. SUMMARY

1.1 This report looks at recent treasury management developments, in particular, the Department of Communities and Local Government (DCLG) consultation on Guidance over local authority investments, and the revised CIPFA Code of Practice on Treasury Management. The report also outlines proposals to amend the current Lending List.

2. RECOMMENDATIONS

2.1 Members are asked to note and comment on

a) The steps taken either previously or in response to the DCLG draft guidance and revised CIPFA Code.
b) The proposals in paragraph 3.10 to amend the Lending List

3 DETAIL

DCLG Guidance

3.1 Under the Local Government Act 2003, the DCLG issues Guidance on local authority investments. Following the Icelandic banking crisis, and the subsequent House of Commons report, the DCLG has issued draft Guidance for consultation. The main points made in the draft Guidance are as follows:

a) Security and liquidity are the key issues in lending. There should clear policies on the duration of loans, and the share of the portfolio that can be lent for longer periods.

b) The Treasury Strategy should be approved by Full Council. Authorities should consider sending revised strategies to members during the year.

c) The Treasury Strategy should be published.

d) Local Authorities should not rely solely on credit ratings but consider other information.

e) The Treasury Strategy should comment on the use of advisers.

f) The Treasury Strategy should comment on the investment of money borrowed in advance of need. The Guidance confirms that it is legitimate for authorities to borrow in advance, but is concerned that the consequent loans into the market should be legitimate and not be speculative.

g) The Treasury Strategy should comment on how staff training is reviewed and training needs met.

Comment and response to the DCLG draft Guidance

3.2 Members will be aware that officers have taken and planned a number of actions in response to the Icelandic bank collapse. It is important to recognise that there will be periodic bank crises, and that these will take different forms. However, local authorities must ensure that their policies and practices are sound and that risks are appropriate. Commenting on the draft Guidance:

a) The Treasury Strategy for 2010/11, which is included as part of the Budget papers, will include the various points made in the draft Guidance, as the final Guidance is unlikely to be published in time to meet the Budget timetable.

b) As part of the ongoing review of treasury arrangements, Brent Council is tendering for a treasury adviser as the current contract with Butlers is due for renewal. The tender will ask potential advisers about how they have revised their approach in the light of the Icelandic collapse, and the criticisms made of over-reliance on credit rating agencies. However, it will continue to be clear that Brent Council takes responsibility for decisions – advisers issue advice.

c) The issue of borrowing in advance is important and should be explained in the Treasury Strategy. Brent Council has sought to maintain borrowing at the most efficient level, usually considered to be the Credit Ceiling that reflects capital expenditure. At present, because short term rates are so low, the Council has borrowed less than the ceiling. However, when it is considered likely that rates may rise and increase costs over a 50 year period, early borrowing may be undertaken. This may be particularly important where major expenditure is planned, as with the Civic Centre.

d) The response to the DCLG will welcome the Guidance, but will raise concerns about the increasing detail required in a strategy – for example, details of staff training that are more appropriate for the CIPFA Code, and the requirement for publication – and the issues surrounding security and yield. In order to avoid all risk, an authority would either lend to the Debt Management Office (DMO) or invest in government gilts. Over a period, lending to the DMO will give much lower returns than lending to the market. Although no local authority will wish to risk their capital, there is a trade-off between security and yield, and an impact on budgets. The response will also question the requirement that the Treasury Strategy should be agreed by Full Council – it is felt to be more appropriate that there should be full scrutiny through an Audit Committee.

Revised CIPFA Code of Practice on Treasury Management (the Code)

3.3 The Full Council adopted the 1996 CIPFA Code in May 1997, and the 2002 Revised Code in July 2002. Although the 2009 revised Code is very similar to previous documents, there are some important changes following the Icelandic banking crisis. These are:

a) A mid year review of the annual treasury strategy, looking at activities undertaken and any variations from agreed policies / practices

b) The Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

c) The Director of Finance and Corporate Resources to ensure that members tasked with treasury management responsibilities have access to appropriate training opportunities.

3.4 A mid-year review of treasury strategy will be introduced in 2010, though the Annual Report already includes commentary on developments since the beginning of the new financial year. The issues of effective scrutiny and training for members will continue to be addressed over the next year.

Developments since the last meeting of the Audit Committee

3.5 Members will be aware that Brent deposited £15m with Icelandic banks in 2008 - £10m with Heritable Bank, and £5m with Glitnir Bank. The first repayment of £1.6m (16%) was received from the administrators of Heritable (Ernst & Young) in July 2009, and a second payment of £1m is expected in December. The improvement in the property markets should assist recovery prospects. On Glitnir, legal advice is that Brent should recover the whole of its deposit as the council will be classed as a secured creditor. However, it is likely that there will be legal challenges from other unsecured creditors.

3.6 Ernst & Young have estimated that local authority creditors may recover around 80% of their deposits with Heritable, leaving a potential shortfall of £2m. The DCLG have previously allowed local authorities to delay accounting for the potential shortfall in budgets until 2010/11. As the potential loss of £2m would have serious implications for Brent, it is proposed that the Council applies for permission to capitalise the £2m over twenty five years.

3.7 Following the collapse of Lehman Brothers and the Icelandic crisis, most local authorities reviewed their lending lists to reduce risk. A Society of London Treasurers' survey indicates that most boroughs are experiencing difficulties identifying investment counterparties and placing surplus cash. Most have reduced the duration of deposit. However, many are seeking to increase investment flexibility as markets return to more normal conditions.

3.8 A list of deposits as at 30th November 2009 is attached as Appendix 1. Most of the cash deposits, excluding those with money market funds that support cash flow requirements, are long-term at relatively high interest rates. Markets have generally become more confident, and interest rates charged on lending between banks (the 'wholesale market) have reduced. On this basis, the Council has met most cash requirements by borrowing short term, at around 0.25% / 0.4%, rather than long term at around 4.4%. However, although short term rates are expected to stay low – around 0.5% until towards the end of 2010 – economists are forecasting that longer term rates may rise by around 1% as Quantitative Easing ceases and government debt issuance grows. On this basis, it will be prudent to borrow longer term to fund the capital programme. However, the concerns over debt owned by Dubai have highlighted that credit bubbles still exist within the world economic system.

3.9 Additional long term borrowing may mean – in the short term – additional deposits using the proposed new Lending List. In addition, long term deposits are gradually maturing, increasing balances. Members will be aware that the implementation of a new Lending List has been postponed during the credit crisis. The Council has used a severely reduced List since October 2008, and removed the building societies in April 2009 following the rescue of Dunfermline building society (see Appendix 2 for the existing List).

3.10 The Director of Finance is proposing:

a) To implement the new Lending List in 2010 using the criteria previously seen by members in my report of March 2009, but to delay action until the issues surrounding the Dubai default are clarified. Exposure will be limited to developed markets with AA sovereign ratings.

b) To remove lending limits at once to government agencies and other local authorities, as these offer full security.

c) To include at once call accounts with appropriately rated banks, which currently offer improved interest rates, but require notice periods of at least seven days.

d) To increase the duration of deposits. At present, no deposits are made for more than one month, but this reduces return opportunities sharply. As the banks included on the current list are implicitly guaranteed by the government (in that they are able to issue bonds), there may be opportunities to lend for up to one year at higher rates.

e) As stated above, all the building societies were removed from the Lending List in April 2009 following the rescue of the Dunfermline Building Society. However, Nationwide Building Society continues to enjoy good credit ratings (on a par with the major lending banks) and has the security of being one of the original eight institutions allowed to issue bonds supported by the government. As it features regularly in the market, it is proposed to reinstate Nationwide to the List. Further information on other building societies will be available as they announce their annual results.

f) To allow the external manager, Aberdeen Asset Management, to invest in both the government guaranteed Certificates of Deposit (CDs) and the individual bank CDs for each bank on the Lending List. This will give increased flexibility with a much reduced Lending List. However, it is likely that Aberdeen will continue to use individual bank CDs as these offer higher yields.

4. FINANCIAL IMPLICATIONS

These are covered in the report.

5 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 STAFFING IMPLICATIONS

None

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8 BACKGROUND

Annual Treasury Strategy – Report to Full Council (and the Audit Committee) as part of the Budget Report – March 2009
CIPFA – Treasury Management Code of Practice 2009
DCLG – Draft Guidance to local authorities on investments - 2009

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, on 020 8937 1472/74 at Brent Town Hall.

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Appendix 1

Brent treasury lending list – Icelandic banks

1 The current loans outstanding **as at 30th November 2009** are:

Name	**Amount £m**	**Yield %**	**Lending Date**	**Maturity Date**
Global Treas. Fund (RBS)	0.1	Var.	Call	
Gartmore cash reserve	0.1	Var.	Call	
Northern Trust global fund	0.1	Var.	Call	
Cheshire BS	5.0	1.11	07.05.08	07/05/10
Heritable bank	8.4	5.85	15.08.08	14/11/08
Glitnir	5.0	5.85	15.09.08	12/12/08
Dunfermline BS	5.0	Var.	04.02.08	04/02/10
Newcastle BS	5.0	6.05	28.04.08	28/04/10
Derbyshire BS	5.0	6.4	16.06.08	16/06/10
Dunfermline BS	5.0	5.9	01.07.08	01/07/10
Skipton BS	5.0	6.48	01.07.08	01/07/11
RBS	5.0	Var.	22.09.08	22/09/11
Total	**48.7**			

Members will be aware that the value of deposits declined sharply as a result of Brent repaying £64.75m in long-term debt in March 2009.

Brent has also invested £23.2m (as at 30th November) with Aberdeen Asset Management, which has placed the fund in a mixture of certificates of deposit (CDs) and cash. The list of investments held by Aberdeen is as follows:-

Lloyds TSB CD	2.1	0.46	21.12.09
Lloyds TSB CD	1.0	0.54	04.02.10
RBOS CD	2.3	0.76	07.05.10
Abbey National CD	2.3	0.76	10.05.10
Nationwide BS CD	2.2	0.76	10.05.10
Lloyds CD	1.25	0.93	03.08.10
Barclays CD	2.7	0.93	04.08.10
RBOS CD	2.0	0.93	04.08.10
Clydesdale CD	2.5	1.14	24/11/10
Barclays CD	1.5	1.14	25.11.10
Nationwide CD	2.2	1.15	29/11/10
Accrued interest	0.35		
Abbey deposit account	0.8		
	23.2		

Appendix 2

Current Brent Lending List – 6th October 2009

A. UK BANKS – UP TO £10M for INDIVIDUAL banks or Banking GROUPS as indicated below

Rated AA- or above long, F1+ short term, B/C or above individual, 1 support. Up to one month

Abbey National PLC
Alliance & Leicester – linked with Abbey as part of Bank Santander

Bank of Scotland
Lloyds Bank – linked with Bank of Scotland as part of Lloyds

Barclays Bank PLC
HSBC Bank

National Westminster
Royal Bank of Scotland – linked with Nat West as part of the RBOS group

B. MONEY MARKET FUNDS –UP TO £12M

Rated AAA

Royal Bank of Scotland
Morgan Stanley Cash Fund
Northern Trust

C. DEBT MANAGEMENT OFFICE – NO LIMIT – up to one month
D. OTHER LOCAL OR GOVERNMENT AUTHORITIES (UP TO £12M) – up to one month
E. SUPRANATIONAL INSTITUTIONS – UP to £10M

AAA long term and F1+ short term ratings that are supported by major international organisations such as the USA FED or the European Central Bank. These have only ever been used by external managers