BRENT COUNCIL	**Audit Committee** 3rd March 2010 **Report from the Director of Finance and Corporate Resources**
For Action	Wards Affected: ALL

Treasury Management Strategy and Annual Investment Strategy

1. SUMMARY

1.1 This report sets out the Treasury Management Strategy and Annual Investment Strategy, and outlines current treasury market developments.

2. RECOMMENDATIONS

2.1 Members are asked to note and comment on

a) The Annual Treasury Strategy required under the CIPFA Treasury Management Code of Practice.
b) The Annual Investment Strategy required by the Department of Communities and Local Government under the 2003 Local Government Act.
c) Current market developments

3 DETAIL

3.1 The Annual Treasury Strategy and the Annual Investment Strategy are part of the Budget Report that will go to Full Council. The Annual Treasury Strategy sets out the market background and treasury issues that will be relevant in 2010/11. The Strategy reflects recent changes to the CIPFA Code of Practice. The Annual Investment Strategy (AIS) is more concerned with the security of investments. Recently there have been proposals to amend the strategy to reflect concerns arising out of the Icelandic banking collapse. The AIS reflects the new proposals.

Current market developments

3.2 As set out in the Annual Treasury Strategy, it is expected that UK economic growth will be very slow and that short term interest rates will only rise slowly, if at all. Longer term rates are expected to rise to reflect the government borrowing requirement, the end (or reduction) of Quantitative Easing, and inflation fears.

3.3 January and February 2010 have seen increased market volatility as dealers have focused on European government deficits – in particular, Greece, Portugal and Spain. Although European states have promised support, the market remains volatile and worried about how other governments will repay debts. Worries about the Spanish market have prompted the removal of Banco Santander (and Halifax) from the Brent Lending List. Elsewhere, those countries that have seen recovery are beginning to tighten policy, as in Australia and China.

3.4 As previously discussed with the Audit Committee, there are proposals to review and widen the Lending List. These will not be implemented until the market calms down, though there will be discussions with the new Treasury Adviser to agree options.

3.5 It is anticipated that the next Icelandic debt repayment will be received from the Administrator of Heritable Bank in March (around 20%, or £2m). Recent indications are that the Administrator, Ernst & Young, expect to recover a higher percentage of debt (90% / 95%) than previously expected. There has been no further progress on Glitnir Bank.

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

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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TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT

STRATEGY 2010/11

Introduction

11.1 This section of the report presents:

a. The 2010/11 Treasury Management Strategy setting out the proposed borrowing and lending policy and the factors influencing this over the coming year.

b. The 2010/11 Annual Investment Strategy setting out the security of the investments made by the authority.

11.2 Under the Local Government Act 2003, local authority borrowing is regulated by the Prudential Code, details of which are set out in Section 12 of the Budget Report, and the requirement for an Annual Investment Strategy.

11.3 Members are asked to agree

a) The Treasury Management Strategy for 2010/11 as part of the main recommendations to the report, and to note the changes outlined in para. 11.18.
b) The amendments to the Annual Investment Strategy to cover new requirements on duration (para.4.3), other sources of market information (para. 5.2), use of Advisers (paras 10.1 and 10.2), borrowing money in advance (paras 11.2 and 11.3) and staff training (paras 12.1, 12.2 and 12.3).

Regulatory Requirements

11.4 The 2009 Code of Practice for Treasury Management issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) includes provision for an annual report to Members on the Treasury Management Strategy. The Code requires that Members consider and agree the strategy before the beginning of each financial year. The Treasury Management Strategy is sensitive to interest rate movements, which may affect receipts from interest on balances, or payments of interest on new long term loans to the authority.

11.5 Guidance issued under Section 15 (1) (a) of the Local Government Act 2003 also requires that authorities should prepare an Annual Investment Strategy (AIS) to be agreed by Full Council before the commencement of each year. The AIS is required to set out the security of investments used by the authority, analysed between Specified and Non-Specified investments and clarifying the use of credit ratings. It also has to set out the maximum periods for which funds may prudently be committed (liquidity). To discourage the use of investments that may be considered speculative, such as equities, the acquisition of share or loan capital in any body corporate (such as a company) is defined as capital expenditure. On this basis, Brent does not invest treasury balances in shares, corporate bonds or floating rate notes issued by companies except through pooled schemes.

11.6 The Department for Communities and Local Government (DCLG) has recently issued revised draft Guidance following the collapse of Lehman Brothers and various Icelandic banks, and the House of Commons Select Committee report on local authority investments in Icelandic banks. Although the Guidance remains 'draft', it is proposed to include the main issues raised within the AIS. These are:-

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.
h) The Treasury Strategy should include proposals for regular scrutiny by members.

11.7 The proposed AIS for 2010/11 is attached as Appendix N. Given the issues that have arisen recently as a result of turmoil in financial markets, details of the actions the council plans to take in both the short and longer term with regard to investments and use of credit ratings are set out in this section of the main report.

Economic Background

11.8 The international economic background in 2008 was extremely volatile, with rising oil and commodity prices, and a credit crisis that led to the collapse / takeover / rescue of various banks as inter bank lending and the wider provision of credit reduced. In 2009, recession, low interest rates and market recovery have been the main features, as follows:-

a) Economic growth has been negative. The UK economy shrunk by around 4.5%, the European economy by 4%, and the USA by 2.5%. However, most developed economies have emerged from recession in Q3 2009, and UK GDP grew by 0.1% in Q4 2009.

b) Stock markets fell in anticipation of a recession, but have risen by around 50% since the trough in March.

c) House and property prices fell during the first half of the year, but have risen since.

d) Inflation initially fell sharply on the back of the cut in VAT and falling fuel costs, but has risen by 2.9% for 2009 as a whole.

e) Short term interest rates have remained very low (UK 0.5%, USA 0% - 0.25%, ECB 1%) as Central Banks have sought to support economic activity and recapitalise the banks. The interest rates used for lending and borrowing between banks, LIBOR and LIBID, have reduced towards base rate as expected. Longer term rates have been held down by quantitative easing in UK and USA, but are rising on hopes of economic recovery and the weight of government gilt issuance required to support expenditure.

11.9 Looking ahead to the next financial year, it is expected that world economic growth will accelerate to around 3% / 3.5% in 2010, led by growth in emerging economies such as China. Although the USA economy should grow by around 3% in 2010, it is anticipated that UK and Europe will only grow by around 1% / 1.5%. It is also forecast that UK GDP will only increase by 1.5% in 2011. Interest rates should continue to be very low – UK Bank Rate may remain at 0.5% throughout 2010, possibly rising to 1% towards the end of the financial year. Despite quantitative easing, it is expected that the authorities will have few worries about inflation – although RPI and CPI will rise early in 2010 as a result of VAT rising back to 17.5% and increased oil costs, inflation is expected to fall in the second half of 2010. Long-term rates are expected to rise as governments borrow money to fund recovery programmes and the costs of nationalising / recapitalising banking sectors. However, there remains a risk that deflation will pose a greater threat than inflation, leading to lower rates.

Financial Market Background

11.10 The sub-prime crisis and credit crunch of 2007 – 2009 led to the collapse of a number of banks, either into nationalisation, forced mergers or disappearance. However, the collapse of Lehman Brothers – a key broker and investment bank – in September 2008 caused a financial tsunami to overrun the banking system.

11.11 Although the financial institutions on the Brent Lending List were sound and most were given support by their national banks, three Icelandic banks were put into administration when their credit ratings were reduced and they were unable to meet short term obligations. Brent had two deposits outstanding, as follows:-

Heritable Bank	£10m	Lent 15.08.08	Repayable 14.11.08
Glitnir Bank	£5m	Lent 15.09.08	Repayable 12.12.08

To date, the council has had £2.9m returned by the administrators of Heritable Bank, who suggest that depositors will recover about 80% of their original sum. It is anticipated that the £5m deposited with Glitnir will be returned as legal advice is that the deposit will be treated as a preferential creditor However, progress is likely to be slow in the light of legal challenges, especially from the Winding up Board for the Bank. If the deposits are not returned in 2010/11, the lost interest will be around £60,000 (assuming an interest rate of 0.5%).

11.12 In the light of the turmoil on the financial markets, the Lending List agreed by the Director of Finance & Corporate Resources was reconstructed to reduce risk – initially foreign and lower rated British banks were removed and lending limited to a duration of one month, then in April 2009 building societies were also removed from the List following concerns about the Dunfermline Building Society. In March 2009 the council repaid early loans from the PWLB valued at £64.75m, thus generating substantial savings (£1.5m per annum) and reducing balances available to deposit with other banks (currently at very low interest rates). The repayment reduced council long term borrowing to £597.5m, £29.5m below the level of the Capital Financing Requirement at the end of the 2008/09 financial year

Lending Policy

11.13 Treasury management is defined as the management of the organisation's cash flows and its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

11.14 Table 11.1 indicates the projected summary cash flow for the authority. It is anticipated that cash balances will be approximately £56m by 31st March 2011 if the council resumes long-term borrowing at the Capital Financing Requirement.

Table 11.1 - Cash Flow Summary 2010/11

	£m	£m
Cash Balances as at 1 April 2010		**50**
Capital programme	(116)	
Debt repayment	(-)	
		(116)
		(66)
Repayment by Heritable	2	
Capital receipts/grants	68	
Payment of debt premia	4	
Long-term borrowing	38	
Minimum Revenue Provision	10	
		122
Cash Balances as at 31 March 2011		**56**
Total long-term borrowing as at 31.03.10		**635**

11.15 It was agreed that the revised list should remain in effect until the problems in the inter-bank market – as represented in the wide spreads between LIBOR /

LIBID and bank rate – were reduced, and to continue to lend for periods of less than one month. Although these measures marginally reduced interest receipts, income has been protected by a number of longer term deposits that run into 2009/10 and beyond. Furthermore, the March 2009 repayment has meant that the Council has had minimal balances to lend.

11.16 In January 2010 it was felt that the market had recovered significantly and that debt defaults would reduce in 2010. Following consultation with the adviser, Butlers, and a report to the Audit Committee, the Director of Finance and Corporate Resources increased loan duration to one year, reinstated a suitably rated building society to the lending list and increased the size of loans to local authority and government institutions, as shown in Table 11.2 below.

Table 11.2 – Current Brent Lending List – February 2010

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

Rated AA- or above long, F1+ short term, B/C or above individual, 1 support (unless part owned by the government or supported by an implicit guarantee). Up to one year

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

Nationwide building society

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 year
D. OTHER LOCAL OR GOVERNMENT AUTHORITIES – up to one year
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

11.17 The 2009 CIPFA Code of Practice in Treasury Management recommends that authorities should have regard to the credit ratings issued by all three main rating agencies, and make their decisions on the basis of the lowest rating. Two of the British banks, Royal Bank of Scotland and Lloyds, are rated lower (A+) by one of the rating agencies, but they have not been removed from the lending list on the grounds that they are part owned by the government as well as supported by an implicit government guarantee that allows them to issue certificates of deposit.

11.18 Over the longer term there are operational difficulties in running a reduced Lending List and a cost in foregone interest receipts. It is proposed that, if market conditions remain calm, the Council returns to using a longer Lending List in April. The Lending List will incorporate the features outlined in the 2009 Treasury Strategy report, as follows:-

a) Sovereign ratings, linked to the country of ownership, to the level of AA (a strong capacity to meet its financial obligations) and above in developed economies. There will be a limit of 20% on individual country exposure, with the exception of UK.

b) An institution will only qualify for the list if its lowest ratings (from one of the three agencies) meet the criteria.

c) Institutions that are part of a financial group (for example, Lloyds TSB includes Lloyds TSB, HBOS, Halifax and Cheltenham and Gloucester) will be subject to a group limit of £10m.

d) The use of independent credit information produced by asset managers, as a check on the Brent List.

e) Following the collapse of Dunfermline Building Society and evidence that regulators were not closely overseeing building societies, these were removed from the Brent List. As the regulatory regime has been strengthened, and there is clear evidence that the sector continues to weed out weaker societies, concerns have faded. Options for building societies to return to the Lending List will be reviewed with our treasury adviser, Butlers. However, to ensure that risk is spread, no more than 50% of in-house deposits will be lent to the building society sector, and amounts lent will be limited to £5m.

f) A minimum rating of A+ long-term (A is high credit quality), F1 short term (up to 13 months – highest credit quality), B Individual (B is a strong bank, with no major concerns about its functions), and 1 Support (extremely high probability of external support) will be applied. These are high quality ratings, but would allow the return of some overseas banks that may be active borrowers whereas most large UK deposit banks will only take very large deposits.

g) No deposits will be made to companies or countries that are on a negative rating watch, unless there is an implicit government guarantee, enabling the bank / building society to issue certificates of deposit.

h) There will continue to be differential lending periods according to credit rating, but a common maximum deposit of £10m, apart from government related agencies and AAA rated money market funds. The maximum lending period will be reduced to three years (with senior management approval).

11.19 Details of the basis on which credit ratings are used are set out in Table 11.3 below.

Table 11.3 – Use of Credit Ratings

a) The credit rating agencies (Fitch, Moody's and Standard & Poor) meet with financial institutions, review their financial prospects and issue ratings.

b) The main source of ratings used by Brent is Fitch, which uses four sets of criteria which can be used as an overall grid. This approach should reduce risk, and is followed by a number of other authorities – though some authorities only use two ratings (long term credit and short term credit). The other two rating agencies do not issue support ratings.

c) The Fitch ratings are as follows:

   i. Long term credit ratings are a benchmark of probability of default. The scales are split between investment and speculative grade – Brent only uses investment grade, which is spread from AAA – highest credit quality – to BBB – good credit quality.

   ii. Short term credit ratings are a benchmark of the probability of default, but with a 13 month time horizon. These are usually most relevant to our activity. The scale spreads from F1 (P1 for Moody's) – highest credit quality – to D, which is default.

   iii. Individual ratings are assigned only to banks and attempt to assess how a bank would be viewed if it were entirely independent and could not rely on external support. The rating looks at soundness of balance sheets and business models. There are often no ratings for subsidiaries. The scale spreads from A, a very strong bank, to F, a bank that has either defaulted or would have defaulted had it not been given support.

   iv. Support ratings indicate whether or not the bank will receive support should this be necessary. The scale spreads from 1, extremely high probability of external support, to 5, where support cannot be relied upon.

11.20 At present, the investment company, Aberdeen Asset Management, manages an external portfolio valued at £23m, whereas the in-house manager has around £30m. There is previous authorisation for a second external manager, but it is felt to be prudent to wait for more stable markets before making an appointment. The external manager follows the Brent lending list, and is allowed to use certificates of deposit (CDs), supranational bonds, government gilts and cash to enable them to improve performance, with a target of outperforming their benchmark by 0.5% per annum. The manager outperformed substantially in 2008/09, and has outperformed again in 2009/10 to date using longer dated (one year) CDs. It is felt prudent to retain external managers with different benchmarks, encouraging diversification.

11.21 As set out above, rates are at 0.5% and are expected to remain at that level or rise marginally (to 1%) during the year. In-house activity will continue to benefit from previous long-term deposits that will continue into 2010, and will seek to lend for longer periods when appropriate. However, reduced cash balances following the March 2009 restructuring ensures that most cash is used for day to day cash flow purposes. The 2010/11 budget assumes that Brent will receive a further payment from Heritable bank (20% in July 2011), but no payments from Glitnir, and that there will be no interest paid on deposits that are outstanding.

Borrowing Policy

11.22 Long-term interest rates initially fell in 2008/09 as quantitative easing reduced the cost of borrowing. However, rates have recovered to their initial levels (50 year 4.5%) as markets looked through the end of quantitative easing and toward the sharp increase in gilt issuance. It is anticipated that long-term rates may rise further in 2010/11, but there are conflicting pressures. Rates may be reduced as a result of deflationary fears, or increases in taxation / reductions in government expenditure. The budget uses a prudent assumption of an average interest rate of 5%.

11.23 Borrowing policy in 2010/11 will be determined by a number of factors:

a) The Capital Financing Requirement (CFR). This is the difference between the authority's total liabilities in respect of capital expenditure financed by borrowing and the provision that has been made to meet those liabilities in the revenue accounts. Research by the council's treasury advisers has previously indicated that CFR has been the most economical level for the authority's long-term debt. In 2010/11 a further £30m (assuming that borrowing was at CFR at the beginning of the year) new debt would be required in line with the CFR. However, whereas before 2008 the interest rate curve had been 'inverted', with long term rates lower than short term rates, the curve has now normalised so that it may be advantageous not to borrow up to CFR but use relatively cheaper, short term debt and reduce lending. However, if long term rates are expected to rise to allow the government to fund its deficit through gilt issuance, it may be advantageous to take long term debt despite the short term cost. Alternatively, if short-term interest rates remain low, some debt may be taken at variable rates that follow short-term rates. This approach has the advantage of reducing borrowing costs if rates remain low, matching reduced receipts from lending.

b) The need to borrow. The cash flow summary indicates a need to borrow in 2010/11 if the target is CFR.

c) Movements in interest rates during the year. The current 50 year gilt rate of 4.5% is, theoretically, composed of elements to cover expected inflation (2.5% - 3% for RPIX), a real yield (usually about 2.5% - 3%) and a risk premium (around 0.5%). This implies either that current long-term rates are low and may rise marginally, or that inflation will remain very low and that the risk premium is lower. Market commentators expect inflation to remain low, at least in the short term (after an initial 'blip'), but are less optimistic over the medium term.

d) The prudential limits to borrowing as agreed by Full Council (see Prudential Code section of the Budget Report, Section 12).

11.24 It is proposed to borrow a further £38m in 2010/11 for the main capital programme. Officers will also look at market forecasts to confirm the advantages/disadvantages of borrowing early to fund major developments. Additional loans may also be taken if restructuring opportunities are evident or anticipated.

Prudential Indicators

11.25 Under the revised Treasury Management Code issued in 2009, the treasury prudential indicators are to be included within the treasury management strategy report. The Code requires increased analysis of loan duration, so that all loans above ten years are shown in ten year bands. The prudential indicators are as follows:

a. Adoption of the CIPFA Code of Practice for Treasury Management. This was adopted by the Council in September 2002. Amongst other things, it requires publication of an annual treasury management strategy and investment strategy.

b. Exposure *to changes in interest rates:*
   - *Upper limit on net borrowing at fixed interest rates.* This has been set at 100% on the basis that all net borrowing may be at fixed rates if it is anticipated that short-term rates are set to rise and long-term rates are perceived to be low. Variable interest borrowing would be retained up to the level of any variable interest investments;
   - *Upper limit on net borrowing at variable rates.* This has been set at 40%. Variable rate borrowing is held as a hedge against variable rate investments. It also may be held where variable interest rates are low compared to fixed rates and fixed rates are expected to fall. The upper limit has also been set with debt restructuring in mind.

c. *Maturity structure of borrowing.* Upper and lower limits on proportion of fixed interest loans that mature in:
   - Under 12 months;
   - Between 12 months and 24 months;
   - Between 24 months and 5 years;
   - Between 5 and 10 years;
   - Between 10 and 20 years
   - Between 20 and 30 years
   - Between 30 and 40 years
   - Between 40 and 50 years

   The limits have been set to allow flexibility to manage loan durations but also to avoid having too much exposure to maturing loans in any period.

d. *Total investments.* The limit proposed allows flexibility for either external managers or the in-house team to lend for longer periods than one year if interest rates make this advantageous. The limit has been reduced to £40m to reflect lower balances.

Table 11.4 Prudential Indicators for Treasury Management

	2009/10	2010/11	2011/12	2012/13	2013/14
Treasury Management Code adopted	Yes	Yes	Yes	Yes	Yes
Exposure to interest rate changes: Upper limit on fixed rate interest (% of net borrowing)	100%	100%	100%	100%	100%
Upper limit on variable rate interest (% of net borrowing)	40%	40%	40%	40%	40%
Maturity of fixed interest loans:					
Under 12 months: ○ Upper limit ○ Lower limit	40% 0%	40% 0%	40% 0%	40% 0%	40% 0%
Between 12 and 24 months: ○ Upper limit ○ Lower limit	20% 0%	20% 0%	20% 0%	20% 0%	20% 0%
Between 24 months and 5 years: ○ Upper limit ○ Lower limit	20% 0%	20% 0%	20% 0%	20% 0%	20% 0%
5 to 10 years: ○ Upper limit ○ Lower limit	60% 0%	60% 0%	60% 0%	60% 0%	60% 0%
10 to 20 years: ○ Upper limit ○ Lower limit	100% 30%	100% 30%	100% 30%	100% 30%	100% 30%
Upper limit on Investments of more than one year:	£60m	£40m	£40m	£40m	£40m

Debt Restructuring

11.25 Many long-term loans were borrowed from the PWLB during periods when interest rates were high. The regulations under which such loans were given prevent their repayment without incurring substantial premia to reflect any difference between current low rates and previous higher rates. This could make the repayment of long-term debt with high interest rates expensive, especially if charged to the revenue budget for any one year.

11.26 Market loans known as LOBOs (Lenders Option, Borrowers Option) are long-term loans (up to 70 years) that allow the lender the option to increase the rate after a period of years. The borrower also has the option to refuse to pay a higher rate and repay the loan without incurring a penalty. Local authority debt is regarded as of high quality to lending institutions that are keen to grow such business on their loan books. To date Brent has taken 13 LOBOs, valued at £85.5m. The council may take more LOBOs if opportunities arise, subject to limiting council's exposure to potential increases during the period of the loan.

11.27 There are also other occasions when refinancing may be advantageous:

a) When rates rise, but are expected to fall again later. In such cases it may be advantageous to switch to variable rate debt before fixing back into lower rates.

b) If debt has a short period to maturity but market interest rates are unduly pessimistic.

11.28 It is proposed to continue monitoring opportunities for debt restructuring and to take action as circumstances allow. In a low interest rate environment, there are fewer opportunities to restructure. At present the council's main lender, the Public Works Loans Board (PWLB), has changed its terms to charge a larger premium on debt repaid prematurely. However, the PWLB is reviewing its repayment terms in 2010, which may facilitate more restructuring activity.

Member Engagement

11.29 Before 2008, two Treasury Management reports were made each year, unless important issues arose. The reports were the Strategy report, when setting the budget, and the Outturn report at year end. However, since the collapse of Lehman Brothers and the default of the Icelandic banks, there have been reports on lending activity to each meeting of the Audit Committee, setting out deposits at the end of each quarter and how the lending list has changed over the period. Other papers have detailed the report of the Commons Select Committee on local authority lending to Icelandic banks, the revised CIPFA Treasury Management Code of Practice and the DCLG Guidance on local authority investments.

11.30 The revised CIPFA Treasury Management Code of Practice makes some changes to previous practice, as follows:-

a) A mid-year review of the annual treasury strategy, looking at activities undertaken and any variation from agreed policies / practices.
b) The Audit Committee is to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

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

As part of this, it is proposed that this treasury management strategy and the annual investment strategy are considered by the Audit Committee at its meeting in March 2010.

ANNUAL INVESTMENT STRATEGY 2010/11

1. Brent Council has regard to the Department for Communities and Local Government Guidance on Local Government Investments ("Guidance") and CIPFA's 'Treasury Management in the Public Services'.

2. Investment Principles

2.1 All investments will be in sterling. The general policy objective is the prudent investment of the council's treasury balances. The council will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.

2.3 The Guidance maintains that the borrowing of monies purely to invest or on-lend to make a return is unlawful. The council will not engage in such activity.

3. Specified and Non-Specified Investments

3.1 Investment instruments identified for use in the financial year are listed in Appendices N(ii) and N(iii) under the 'Specified' and 'Non-Specified' investments categories. These are defined as follows:

a) Specified Investments (as set out in the Guidance) are those that offer high security and liquidity. Such investments will be in sterling, with a maturity of no more than one year, and will be made to bodies with high credit ratings – UK or local government, banks, building societies, money market funds, and supra-national institutions.

b) Non-specified Investments (as set out in the Guidance) are those that may either entail more risk or are more complex, such as gilts, certificates of deposit or commercial paper. In all cases where time deposits (loans with a fixed maturity date to banks, building societies etc) are not involved, external fund managers will take investment decisions within their Investment Management Agreements.

3.2 Appendices N(ii) and N(iii) also set out:

(a) the advantages and associated risk of investments under the category of "non-specified" category;

(b) the upper limit to be invested in each 'non-specified' asset category;

(c) which instruments would best be used by the council's external fund managers or after consultation with the council's treasury advisors.

4. Liquidity

4.1 Based on its cash flow forecasts, the council anticipates its fund balances in 2010/11 to range between £40m and £80m.

4.2 Giving due consideration to the council's level of balances over the next three years, the need for liquidity, its spending commitments and provisioning for contingencies, the council has determined that up to £30m may be held in 'non specified' investments during the year.

4.3 Appendices N(ii) and N(iii) set out the maximum periods for which funds may be prudently committed in each asset category. The duration of cash deposits has been shortened to three years (from five years) following severe volatility seen in the recent credit crisis. However, the current lending list will continue to use the shorter limit of one year to recognise that the banking system has not yet healed from the credit crisis.

5. Security of Capital: The Use of Credit Ratings

5.1 Credit quality of counterparties (issuers and issues) and investment schemes will, in the first instance, be determined by reference to credit ratings published by Fitch IBCA, Standard and Poor's, and Moody's *(*long-term/short-term, individual, support and sovereign), but the council will use the lowest ratings from the three companies. The Council will also use group and national limits to assist in proper diversification of investments, as well as duration limits. The external manager will use Brent Council's Lending List to establish authorised borrowers.

5.2 Monitoring of credit ratings:

- All credit ratings will be monitored continuously. Brent Council is alerted to changes in ratings through the adviser's (Butler) website and emails.
- If it is anticipated that a downgrading may occur following adverse economic developments; the Head of Exchequer & Investments or a dealer will have discretion to remove the counterparty from the lending list.
- If a downgrade results in the counterparty/investment scheme / country no longer meeting the council's minimum criteria, its further use as a new investment / investment venue will be withdrawn immediately.
- If a counterparty/investment scheme is upgraded so that it fulfils the council's criteria, the Director of Finance & Corporate Resources will consider including it on the lending list.
- The council will also use other sources of information to assess the credit worthiness of counter-parties and general market intelligence. Advice will be gleaned from financial publications, asset managers and Capital Economics. Access will also be available to the credit lists used by two investment managers used by the council.
- Dealers are expected to act prudently and may decline to use particular counterparties if there is any cause for concern.

6. Investments Defined as Capital Expenditure

6.1 The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure. Brent Council will not use or allow its external fund manager to make, any investment which will be deemed capital expenditure.

7. Investment Strategy to be followed In-House

7.1 Investments will be made with reference to the core balance (£40m), cash flow requirements and the outlook for short and medium-term interest rates (i.e. rates for investments up to 3 years).

7.2 Once stability has returned, the council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest at potentially higher rates, while looking for longer-term opportunities when the market becomes too pessimistic about rising rates. Brent Council has identified 2% as an attractive trigger rate to consider 1-year lending and 5% for 2 and *3* year lending. The 'trigger points' will be kept under review and discussed with Butlers so that investments can be made at the appropriate time.

9. External Cash Fund Management

9.1 Brent Council's funds are managed on a discretionary basis by Aberdeen Asset Management. The fund manager is contractually required to comply with this strategy.

9.2 Brent Council will discuss with its external fund manager on a regular basis, instruments that they consider may be prudently used to meet the council's investment objectives. Brent Council will evaluate the risk-reward characteristics of asset categories to decide whether to permit the manager to use instruments that comply with the Guidance.

10 The role of the treasury adviser

10.1 The treasury adviser gives advice on debt restructuring opportunities, interest rate movements, economic forecasts, external treasury managers and current capital finance developments. The adviser also provides credit ratings, and details of changes / possible changes in ratings.

10.2 However, it is for the council to take decisions on whether or not to act on the advice given. Other sources of market information and intelligence will also be sought.

11 Borrowing in advance

11.1 The council has used the Capital Financing Requirement (CFR) as the most efficient measure of borrowing need. The CFR reflects the total capital expenditure of the authority.

11.2 The council plans that total borrowing should be at, or about, CFR at year end. However, the capital programme may be delayed, leading to total borrowing being above CFR. Other factors will also affect borrowing decisions. If it is expected that long-term rates may rise, borrowing may be undertaken early. This will be particularly important if there is a major project being undertaken, such as the new Civic Centre. If long term rates are high, but short term rates very low (as at present), borrowing may be delayed to reduce funding costs.

11.3 If borrowing is undertaken in advance of need, the balance will be placed with a secure counterparty. If large sums are involved, consideration will be given to purchasing an appropriate government gilt, to preserve capital.

12 Staff training

12.1 There are three main treasury management training 'areas'. First, dealing, requiring understanding of cash flow issues, information systems, the lending list, dealing and settlement of deals. Second, authorisation of deals, requiring knowledge of the lending list and information systems. Third, management requires an understanding of the market, treasury management codes, economic background, and current treasury management policies and strategies.

12.2 Staff training is reviewed on an ongoing basis to ensure that trainee accountants are given an initial treasury induction, and that dealers / managers are given access to market developments and technical updates on treasury issues (particularly changes to the lending list) and regular dealing practice.

12.3 Training needs are met through a variety of methods. New dealers are given on the job induction training, to enable them to deal competently, as well as attendance at relevant external seminars. Ongoing learning is through seminars provided by the main treasury organisations, CIPFA and economics consultancies. The principal treasury officer is undertaking the course in Treasury Management organised by the Association of Corporate Treasurers and CIPFA.

LOCAL GOVERNMENT INVESTMENTS

SPECIFIED INVESTMENTS

All "Specified Investments" listed below must be sterling-denominated.

Investment	Share/ Loan Capital?	Repayable/ Redeemable Within 12 Months?	Security/ Minimum Credit Rating	Capital Expenditure?	Circumstance of Use	Maximum Period
Debt Management Agency Deposit Facility	No	Yes	Govt-backed	No	In-house	1 year
Term or callable deposits with the UK government or with UK local authorities	No	Yes	High security although local authorities are not credit rated.	No	In-house and by external fund manager	1 year
Term or callable deposits with credit-rated deposit takers (banks and building societies)	No	Yes	Yes- varied	No	In-house and by external fund manager	1 year
Certificates of Deposit issued by credit-rated deposit takers (banks and building societies)	No	Yes	Yes- varied	No	To be used by fund managers	1 year
Gilts : with maturities up to 1 year	No	Yes	Govt-backed	No	In house and by external cash fund manager subject to the management agreement	1 year
Money Market Funds (i.e. a highly rated collective investment scheme)	No	Yes	Yes- *minimum : AAA*	No	In-house and by external fund manager subject to the management agreement	*Subject to cash flow and liquidity requirements*

Investment	Share/ Loan Capital?	Repayable/ Redeemable Within 12 Months?	Security/ Minimum Credit Rating	Capital Expenditure?	Circumstance of Use	Maximum Period
Forward deals with credit rated banks and building societies	No	Yes	Yes- varied	No	In-house and fund manager	1 year in aggregate
Commercial paper *[short-term obligations generally with a maximum life of 9 months issued by banks and other issuers]*	No	Yes	Yes- varied	No	External fund managers subject to the management agreement	9 months
Treasury bills [*Government debt security with a maturity less than one year*]	No	Yes	Govt- backed	No	External fund manager subject to the management agreement	1 year
Bonds issued by a financial institution that is guaranteed by the United Kingdom Government	No	Yes	Govt- backed	No	External cash fund managers subject to management agreements	1 year
Bonds issued by multilateral development banks	No	Yes	AAA	No	External cash fund managers subject to management agreements	1 year

LOCAL GOVERNMENT INVESTMENTS

NON-SPECIFIED INVESTMENTS

Investment	(A) Why Use It? (B) Associated Risks?	Share/ Loan Capital?	Repayable/ Redeemable Within 12 Months?	Security/ Minimum Credit Rating	Capital Expenditure?	Circumstance of Use	Max % of Overall Investments	Maximum Maturity of Investment
Term deposits with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	**(A) (i) Certainty of rate of return over period invested.** **(ii) No movement in capital value of deposit despite changes in interest rate environment.** (B)(i) Liquid : as a general rule, but cannot usually be traded or repaid prior to maturity. (ii) Return is fixed even if interest rates rise after making the investment. (iii) Credit risk : potential for greater deterioration in credit quality over longer period	No	No	Yes-varied	No	In-house, authorised by senior management	100%	*3 years*
Certificates of Deposit with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A)(i) Although tradable, can be illiquid in a credit crisis. (B)(i) 'Risk that price may fall during the life of the CD, so that there may be a capital loss if the instrument is sold early.	No	Yes	Yes-varied	No	To be used by fund manager	80%	*3 years*
UK government	(A)(i) Excellent credit quality.	No	Yes	Govt backed	No	External cash	50%	*10 years*

gilts with maturities in excess of 1 year	(ii) Very Liquid. (iii) If held to maturity, known yield (rate of return) per annum ~ aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B)(i) 'Market or interest rate risk' : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.					fund manager only subject to the management agreement		

Investmen t	**(A) Why Use It?** **(B) Associated Risks?**	**Share/ Loan Capital?**	**Repayable/ Redeemable Within 12 Months?**	**Security/ Minimum Credit Rating**	**Capital Expenditure?**	**Circumstance of Use**	**Max % of Overall Investments**	**Maximum Maturity of Investment**
Sovereign issues, excluding UK government gilts : any maturity	(A)(i) Excellent credit quality. (ii) Liquid. (iii) If held to maturity, known yield (rate of return) per annum ~ aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk (B)(i) 'Market or interest rate risk' : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.	No	Yes	AAA	No	External cash fund manager subject to the management agreement	50%	*10 years*
Forward deposits with credit rated banks and building societies for periods > 1 year (i.e. negotiated deal period plus period of deposit)	(A)(i) Known rate of return over period the monies are invested ~ aids forward planning. (B)(i) Credit risk is over the whole period, not just when monies are actually invested. (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period.	No	No	Yes - varied	No	To be used in-house, authorised by senior management	50%	*3 years*
Bonds issued by a financial institution that is	(A)(i) Excellent credit quality. (ii) Relatively liquid. (although not as liquid as	Yes	Yes	AAA / government guaranteed	No	External cash fund manager, subject to the	80%	*3 years*

guaranteed by the United Kingdom Government	gilts) (iii) If held to maturity, known yield (rate of return) per annum, which would be higher than that on comparable gilt ~ aids forward planning, enhanced return compared to gilts. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (B)(i) 'Market or interest rate risk' : Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss. (ii) Spread versus gilts could widen.					management agreement		

Investment	**(A) Why Use It?** **(B) Associated Risks?**	**Share/ Loan Capital?**	**Repayable/ Redeemable Within 12 Months?**	**Security/ Minimum Credit Rating**	**Capital Expenditure?**	**Circumstance of Use**	**Max % of Overall Investments**	**Maximum Maturity of Investment**
Bonds issued by multilateral development banks	(A)(i) Excellent credit quality. (ii) Relatively liquid. (although not as liquid as gilts) (iii) If held to maturity, known yield (rate of return) per annum, which would be higher than that on comparable gilt ~ aids forward planning, enhanced return compared to gilts. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity). (B)(i) 'Market or interest rate risk' : Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss. (ii) Spread versus gilts could widen.	Yes	Yes	AAA or government guaranteed	No	External cash fund manager , subject to the management agreement	80%	*3 years*

* **The prohibition on the use of derivatives** : This prohibition effectively relies on the judgement of the House of Lords in the case of Hazell v The Council of the London Borough of Hammersmith and Fulham and Others in 1991. Their Lordships held that local authorities have no power to enter into interest rate swaps and similar instruments.

  Our treasury adviser, Butlers, believes that as this ruling still stands and was not rescinded by the introduction of the Local Government Act 2003, local authorities do not have the power to use derivative instruments.

APPENDIX 1

Brent treasury lending list – Icelandic banks

1 The current loans outstanding **as at 31st January 2010** are:

Name	Amount £m	Yield %	Lending Date	Maturity Date
Global Treas. Fund (RBS)	2.0	Var.	Call	
Gartmore cash reserve	0.2	Var.	Call	
Northern Trust global fund	0.1	Var.	Call	
Cheshire BS	5.0	1.11	07.05.08	07/05/10
Heritable bank	7.1	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	**49.4**			

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 31st January) 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	1.0	0.45		04.02.10
RBOS CD	2.3	0.57		07.05.10
Abbey National CD	2.3	0.58		10.05.10
Nationwide BS CD	2.2	0.58		10.05.10

Lloyds CD	1.25	0.79	03.08.10
Barclays CD	2.7	0.80	04.08.10
RBOS CD	2.0	0.80	04.08.10
Clydesdale CD	2.5	1.06	24/11/10
Barclays CD	1.5	1.06	25.11.10
Nationwide CD	2.2	1.07	29/11/10
Lloyds TSB CD	2.0	1.09	06/12/10
Accrued interest	0.2		
Abbey deposit account	1.05		
	23.2		