ANNUAL INVESTMENT STRATEGY 2011/12

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 L(ii) and L(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 L(ii) and L(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 2011/12 to range between £30m 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 £20m may be held in 'non specified' investments during the year.

4.3 Appendices L(ii) and L(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 (Arlingclose) 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 Services 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 the treasury adviser (Arlingclose), 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 Arlingclose 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 (Arlingclose) 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 previously used the Capital Financing Requirement (CFR) as a measure of borrowing need, but the low level of short term interest rates means that either short term loans will also be taken or internal cash balances used. 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, which requires understanding of cash flow issues, information systems, the lending list, dealing and settlement of deals. Second, authorisation of deals, which requires 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 conferences and seminars. Ongoing learning is through conferences and seminars provided by the main treasury organisations, CIPFA and economics consultancies. The principal treasury officer has passed 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 gilts with maturities in excess of 1 year	(A)(i) Excellent credit quality. (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.	No	Yes	Govt backed	No	External cash fund manager only subject to the management agreement	50%	*10 years*

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
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 guaranteed by the United Kingdom Government	(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 / government guaranteed	No	External cash fund manager, subject to the management agreement	80%	*3 years*

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, Arlingclose, 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.