BRENT COUNCIL	**Audit Committee** 22nd September 2011 **Report from the Director of Finance and Corporate Services**
For Action	Wards Affected: ALL
Report Title:	**2011 Treasury Annual Report**

1. SUMMARY

1.1 This report attaches the 2011 Treasury Annual Report that was approved by Full Council, and updates members on recent treasury activity.

2. RECOMMENDATIONS

2.1 Members are asked to note and comment on the 2011 Treasury Annual Report and recent treasury activity.

3 DETAIL

3.1 I attach the 2011 Treasury Annual Report that was approved by Full Council.

3.2 The Annual Report includes a market update to July 2011 (paragraphs 3.23 – 3.24). Recent treasury activity has involved borrowing and lending for short periods as cash flow allows. It had been hoped that the Lending List might be expanded to include overseas banks, but the continued volatility has prevented further action.

3.3 Forecasts that interest rates will remain low for some years mean that cash balances are being reduced. However, the new Civic Centre project will require major capital expenditure, so that timing new loans is an important consideration. As part of the strategy to reduce cash holdings, and in response to turbulence in the markets, the external mandate managed by Aberdeen Asset Management has been terminated. However, it is likely that further long term loans will be sought in the autumn.

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 2010.

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.

CLIVE HEAPHY
Director of Finance and Corporate Services

MARTIN SPRIGGS
Head of Exchequer and Investment

BRENT COUNCIL	**Full Council** **12th September 2011** **Report from the Director of Finance and Corporate Services**

For Action	Wards Affected: ALL

Report Title: The Treasury Management Annual Report 2010/11

1. SUMMARY

The purpose of this report is to provide information to members on borrowing and investment activity, and performance compared to prudential indicators during 2010/11. As the Treasury Management Annual Report should be agreed by Full Council, the Executive is asked to recommend it to Full Council for approval. The report will also go to the Audit Committee as part of the scrutiny function required under the 2009 Treasury Management Code of Practice issued by CIPFA.

The Executive, at its meeting on 23 August 2011, resolved to submit the recommendations in the report to Full Council without any further comments.

2. RECOMMENDATIONS

That Full Council:

2.1 Approves the Treasury Management Annual Report (section 3); and Annual Investment Strategy Report (section 4)

2.2 Notes the outturn for prudential indicators (section 5)

2.3 Notes the updated position in 2010/11 (para.3.23 – 3.24).

3. TREASURY MANAGEMENT ANNUAL REPORT

3.1 Full Council adopted the 2009 CIPFA Code of Practice on Treasury Management in Local Authorities in September 2010. The Code stipulates that the Chief Financial Officer should set out in advance to Full Council the treasury strategy for the forthcoming financial year, issue a progress report during the year, and subsequently report the treasury management activities at year-end. The report will also go to the Audit Committee. This section of the report details:-

a) The economic background for 2010/11 (paras 3.6 to 3.7)
b) The agreed treasury strategy (para 3.8)
c) Borrowing activity during 2010/11 (paras 3.9 to 3.12)
d) Lending activity during 2010/11 (paras 3.13 to 3.21)
e) Overall interest paid and received (para 3.22)
f) Developments since the year end (paras 3.23 – 3.24)

3.2 Treasury management in this context is defined as 'the management of the local authority's cash flows, its banking, money market (short term borrowing and lending) and capital market (long term borrowing) transactions; the effective control of the risks associated with those activities; and the pursuit of the optimum performance consistent with those risks.' This means that the pursuit of additional returns must be placed within the framework of the protection of the council's cash balances and a rigorous assessment of risk.

ECONOMIC AND MARKET BACKGROUND DURING 2010/11

3.6 The world economy grew by 4.5% in 2010, whereas the UK grew by 1.6%, USA by 2.9%, and the Euro area by 1.7%, and the Chinese and Indian economies continued to grow rapidly (around 10%). In the UK growth remained slow as banks were unable / unwilling to lend and borrowers were unwilling to increase existing debts. In the USA, quantitative easing (governments buying back debt and increasing the money supply) supported activity and reduced longer term interest rates. In the UK, Retail Price Inflation rose by 4.6% (Consumer Price Index 3.3%) as VAT increased to 20% and energy and other commodity prices rose sharply. However, the bank rate remained at 0.5% as monetary policy sought to encourage economic growth and assumed that inflation would fall to reflect low economic activity. Overnight interest rates remained very low, at 0.25% - 0.45%. Fiscal policy has also been very loose, with the government running a large payments deficit, but policy has been tightened in 2010/11. Markets experienced renewed volatility in April 2010 as Greece, followed by Ireland and Portugal later in the year, required bailouts from the International Monetary Fund and European countries. Concerns about the cost of country bailouts, and the potential impact of their default on European banks and the euro, have encouraged a cautious approach to lending.

3.7 Table 1 shows interest rates charged during the year by the Public Works Loans Board (PWLB), the government agency that provides long term credit to local authorities. Previously, the PWLB enabled local authorities to borrow at similar rates to the government (gilt yield plus 0.15%). However, on 20th October 2010 it was decided that local authorities would pay rates set at gilt yield plus 1% in order to increase revenue to the Treasury, discourage capital projects and encourage local authorities to use their cash reserves. It can be seen that, although PWLB rates have increased, underlying gilt yields have fallen during the year, reflecting the low demand for credit.

Table 1 – PWLB Interest rates during 2010/11

	1st April 2010 %	30 June %	30 Sept. %	31 March 2011 %
10 year	4.19	3.59	3.14	4.58
25 year 50 year	4.47 4.70	4.31 4.32	3.95 4.01	5.23 5.23

STRATEGY AGREED FOR 2010/11

3.8 On the basis of advice and research from Arlingclose, Capital Economics and treasury / pension fund managers, it was anticipated that the bank rate would remain at 0.5% (possibly rising to 1% by the end of the financial year). It was agreed that lending would be kept fairly short (less than one year), that long term loans would be allowed to mature, and that the lending list would be expanded when market conditions allowed. It was also agreed that borrowing would remain flexible, but that the Council would take short term or variable debt if it was likely that rates would stay low. It was also agreed that officers would look for opportunities to restructure debt, but that low rates might make this uneconomic.

BORROWING ACTIVITY DURING 2010/11

3.9 The split of the council's treasury portfolio between fixed interest and variable loans and investments, as at 31 March 2010, is set out in Table 2.

Table 2 – Treasury portfolio at 31st March 2011 – loans and investments

	31.03.10	31.03.2011	
	Actual £m	Planned £m	Actual £m
Fixed rate loans – PWLB	522.0	556.5	491.0
Variable rate loans – PWLB	-	-	-
Variable rate loans – Market	85.5	85.5	95.5
Short-term loans – Market	52.0	-	69.2
Total Debt	**659.5**	**642.0**	**655.7**
INVESTMENTS	**69.0**	**56.0**	**57.5**
NET DEBT	**590.5**	**586.0**	**598.2**

3.10 The average rate of interest payable by Brent Council on its loans has fallen from 4.6% in 2009/10, to 4.37% in 2010/11. A debt restructuring was undertaken in October 2010, repaying £50m of PWLB loans and taking advantage of cheaper short term debt. The saving will be around £700,000 per annum, depending on short term interest rates. The Debt restructuring of £64.8m, undertaken in March 2009, continues to save around £1.5m per annum as rates remain low. Also in 2010/11 Brent Council took a new PWLB £20m equal instalment of principal loan at 2.94% (10 years).

3.11 As outlined above, the PWLB has increased the rates charged on loans to gilts plus 1%. This has increased the cost of new loans and will discourage debt restructuring activity.

3.12 The duration and average interest rate, of loans in the treasury portfolio at 31st March 2011 is set out in Table 3.

Table 3 – Treasury portfolio at 31st March 2011 – duration/interest rates

Maturing Within	£m 31.03.10 31.03.11		Share of total debt %	Average Interest Rate 2010/11 %
1 Year	52.0	71.2	10.9	0.58
1 – 5 Years	-	8.0	1.2	2.94
6 - 10 years	10.0	9.0	1.4	2.94
11 – 15 years	5.0	5.0	0.8	8.88
Over 15 years	507.0	467.0	71.2	5.08
Variable PWLB	-	-	-	-
Variable Market	85.5	95.5	14.5	4.31
TOTAL	**659.5**	**655.7**	**100.0**	**4.37**

LENDING ACTIVITY DURING 2010/11

3.13 The council's investments averaged £78m during 2010/11 (£86m during 2009/10) and earned £0.9m in interest. Returns were assisted by the declining portfolio of long term deposits (deposited in 2007 and 2008 for up to three years), some of which continued to generate returns in excess of 5% per annum when overnight rates had fallen to 0.25%. The amount invested varied from day to day depending on cash-flow and the Council's borrowing activity. Responsibility for investing funds was split between the in-house team, which manages approximately two thirds of the investments and an external house managing approximately one third of the investments.

3.14 Investments by the in-house team were made primarily with the intentions of achieving security and liquidity, and were all placed with for money market funds or for periods up to one month. Rates achieved ranged between 0.25% and 0.83%, but existing long term loans raised the average rate achieved to 1.3% (2009/10 2.54%). Loans were made to high quality counterparties included on the Treasury Lending list. Appendix 1 lists the deposits outstanding at 31st March 2011.

3.15 The financial tsunami following the bankruptcy of Lehman brothers forced a number of banks into administration in the autumn of 2008, and the collapse of the main Icelandic banks (7th October 2008). Brent Council has two deposits outstanding with Icelandic banks, as follows:-

Heritable	£10m	5.85%	Lent 15.08.08	Due back 14.11.08
Glitnir	£5m	5.85%	Lent 15.09.08	Due back 12.12.08

3.16 The Council continues to work with the Local Government Association and other authorities to recover the loans. All other deposits have been repaid on time. The most recent advice from CIPFA, the Department for Communities and Local Government (CLG) and the Local Government Association (LGA) states that authorities are likely to be treated as preferred creditors to Glitnir.

However, the Winding Up Board (WUB) for Glitnir has proposed that local authority deposits be treated as ordinary creditors (only likely to recover around 30% of their losses), meaning that legal action will continue – our legal advisers, Bevan Brittan, believe that the deposit will be recovered. Hearings before the district court in Iceland have been successful, but the WUB has appealed to the Icelandic Supreme Court. Further hearings are expected in September. The administrators for Heritable have repaid a further £2.1m in 2010/11, a further £1,030,000 to date in 2011/12, and state that creditors should receive 80% / 85% of deposits plus interest to October 2008, by instalments to 2013.

3.17 External cash managers were initially appointed in 1998 to manage two portfolios with the aim of achieving an improved return at an acceptable level of risk. Aberdeen Asset Management has managed a portfolio throughout the period. The value of the Aberdeen's portfolio was £23.6m as at 31st March 2011 (£23.3m 2010). Actual performance for 2010/11 (2009/10 in brackets), and the three and five years to 2010/11 are set out in Table 4.

Table 4 - Performance of Aberdeen Asset Management and the In-House team against benchmark

	Aberdeen %		Brent in-house %	7 Day LIBID Benchmark %
2010/11	2.0 (1.9)		1.3 (2.8)	0.5 (0.4)
Three Years	3.6		3.4	1.4
Five Years	4.25		3.85	3.0

3.19 Aberdeen outperformed the benchmark in 2010/11 by using longer dated certificates of deposit of up to twelve months duration with financial institutions on the Brent lending list.

3.20 The in-house team did not have access to the same wider range of lending instruments as the managers (gilts or CDs), but was able to add value by using money market funds (pooled funds managed by city finance houses) and benefiting from previous long term deposits made in 2007 and 2008.

3.21 The three and five year records indicate that Aberdeen has achieved their out-performance target (+0.5% per annum). Aberdeen is among the best managers over all periods (there are around ten in the market).

TOTAL INTEREST PAID AND RECEIVED

3.22 Total interest paid and received in 2010/11 is shown in Table 5. The reduced interest paid on external debt reflects the restructuring in October 2010 and short term borrowing at lower rates. The reduced interest received on deposits reflects lower market rates and lower cash balances.

Table 5 – Overall interest paid and received in 2010/11

	Budget £m	Actual £m
Interest paid on external debt	31.0	29.7
Interest received on deposits	1.7	0.9
Debt management expenses	0.4	0.2

By way of comparison, interest received on deposits was £7.0m in 2008/09 (budget £3.5m) and £2.2m in 2009/10 (budget £3.0m).

DEVELOPMENTS SINCE THE END OF THE YEAR

3.23 Although the UK financial markets have been fairly calm since the end of the financial year, markets continue to worry about credit worthiness and debt owed by Portugal, Ireland, Italy, Greece and Spain. Short term interest rates remain very low, and long term rates have fallen in response to 'flight to safety' concerns and the growing belief that economic recovery will be very slow and monetary conditions loose. The list of loans outstanding as at 30th June 2011 is attached as Appendix 2.

3.24 In response to concerns about the impact of the Greek debt crisis, fears about possible contagion in Italian and Spanish markets, and proposals to change the ratings for various UK banks, Arlingclose issued advice at the end of June that local authorities should restrict lending to less than 12 months for UK banks. Although the in house team has restricted duration, Aberdeen used CDs that have duration of close to one year. As it has been anticipated that the Aberdeen mandate would be terminated in 2011 to fund capital expenditure requirements, it was felt that early termination would be appropriate to avoid any turbulence in the market.

4 ANNUAL INVESTMENT STRATEGY

4.1 Regulations issued under the 2003 Local Government Act require that councils agree an Annual Investment Strategy (AIS) before the beginning of each year, setting out how investments will be prudently managed with close attention to security and liquidity. The AIS for 2010/11 was agreed by Full Council in March 2010. The AIS sets out the security of investments used by the authority analysed between Specified (offering high security and liquidity, with a maturity of no more than one year) and Non-Specified (entailing more risk or complexity, such as gilts, certificates of deposit or commercial paper) investments. The AIS also sets out the maximum duration of deposits.

4.2 To discourage the use of investments that may be considered speculative, the acquisition of share or loan capital in any body corporate (such as a company) is defined as capital expenditure. On this basis, the Council does not invest treasury balances in shares, corporate bonds or floating rate notes issued by companies, though there is authority to invest through pooled schemes which are not considered capital expenditure.

4.3 Treasury activity has complied with the AIS in 2010/11. The approach has been to lend for short periods to high quality counterparties, reducing risk. As loans have matured, receipts have been used to minimise borrowing.

5. PRUDENTIAL INDICATORS – 2010/11 OUTTURN

5.1 The introduction of the new prudential system of borrowing in the 2003 Local Government Act (LGA) gave new opportunities for councils to assess their requirements for capital spending, and not have them restricted by nationally set approvals to borrow money (credit approvals), as previously. The new system also brought new responsibilities on councils to ensure that:

a) capital expenditure plans are affordable;

b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

c) treasury management decisions are taken in accordance with good professional practice.

5.2 Under regulations issued under the 2003 LGA councils are required to follow the Prudential Code issued by CIPFA which sets out how councils ensure responsible use of new freedoms. The Code details indicators that councils are required to set before the beginning of each year, to monitor during the year, and to report on at the end of each year.

5.3 The outturn for prudential indicators measuring affordability is set out in Table 6. General Fund and HRA capital financing charges as a proportion of total budget were lower than the original estimates as a result of the reduced requirement to fund expenditure from unsupported borrowing in 2010/11.

Table 6 – Prudential indicators measuring affordability

	2010/11 (estimates)	**2010/11 (actual)**
Capital financing charges as a proportion of net revenue stream:		
- General Fund	9.27%	7.68%
- HRA	36.4%	35.67%
Impact of unsupported borrowing on:		
- Council tax at Band D	£4.68	£2.42
- Weekly rent	-	-

5.4 The outturn for prudential indicators for capital spending is set out in Table 7. Movements within the capital programme, including slippage between years and resources becoming available during the year, are to be reported in the Performance and Finance Quarter 4 Outturn report to the Executive in August 2011. Capital spending is funded from a variety of resources, including government grants, capital receipts, revenue contributions, Section 106 contributions and borrowing. This means that movements in capital spending are not directly reflected in movements in the CFR, which principally reflects borrowing requirements. Total borrowing in 2010/11 was lower than anticipated which meant a reduction in the overall CFR.

Table 7 – Prudential indicators measuring capital spending and CFR

	2010/11 Estimates £m	**2010/11 Actual £m**
Planned capital spending:		
- General Fund	133.383	99.752
- HRA	20.127	14.493
- Total	153.510	114.245
Estimated capital financing requirement for[1]:		
- General Fund	371.526	350.543
- HRA	337.724	331.264
- Total	709.250	681.807

5.5 The Council also sets prudential indicators for external debt as shown in Table 8. This is to ensure that the council's overall borrowing is kept within prudent limits. The authorised limit for external borrowing is set flexibly above the CFR to allow for opportunities to restructure debt or borrow early when interest rates are favourable. The Operational Boundary sets out the expected maximum borrowing during the year, allowing for cash flow, interest rate opportunities and restructuring. In 2010/11 the council undertook a debt restructuring of £50m, but did not exceed the Operational Boundary.

Table 8 – Prudential indicators for external debt

Indicator	**Limit**	**Status**
Authorised limit for external debt	£929m	Met
Operational boundary for external debt	£829m	Met
Net borrowing	Below CFR	Met

5.6 The prudential indicators for treasury management, which are included in Table 9 below, were all met. These are set to ensure that interest rate exposures are managed to avoid financial difficulties if interest rates rise sharply. Although borrowing at variable rates can be advantageous if rates are falling, a sharp rise can cause budget difficulties, and force the Council to fix rates at an inopportune time. Again, managing loan durations ensures a variety of maturity dates to avoid all re-financing when rates may be high. Finally, the upper limit on investments of more than one year allows flexibility to lend for longer periods if interest rates make this advantageous, particularly

[1] The Capital Financing Requirement estimates in this table are at 31st March of each year.

by external managers investing in gilts, but also ensures that a minimum level of balances is available for cash flow purposes. Deposits have been short term, and long term loans have been run down during the year.

Table 9 – Prudential indicators for treasury management

Indicator	Limit	Outcome
Treasury Management Code		Adopted
Exposure to interest rate changes		
- fixed rate upper limit	100%	100%
- variable rate upper limit	40%	21%
Maturity of fixed interest loans		
Under 12 months		
- upper limit	40%	0%
- lower limit	0%	0%
12 months – 24 months		
- upper limit	20%	1%
- lower limit	0%	0%
24 months – 5 years		
- upper limit	20%	1%
- lower limit	0%	0%
5 years – 10 years		
- upper limit	60%	2%
- lower limit	0%	0%
Above 10 years		
- upper limit	100%	98%
- lower limit	30%	96%
Upper limit on investments of more than one year	**£60m**	**£20m**

6. MINIMUM REVENUE PROVISION

6.1 The Local Authorities (Capital Finance and Accounting) Regulations 2003 set out the requirement that councils set aside a minimum of 4% of their General Fund capital financing requirement to repay principal on debt, regardless of the length of life of the asset that was being financed.

6.2 Revised regulations which amend this requirement were issued in 2008.[2] Under the new regulations councils are required to set an amount of Minimum Revenue Provision which is 'prudent'. The definition of what counts as 'prudent' is set out in statutory guidance which has been issued by the Secretary of State for Communities and Local Government and which authorities are required to 'have regard' to.

6.3 Under the guidance councils are required to prepare an annual statement of their policy on making Minimum Revenue Provision to Full Council. The purpose of this is to give Members the opportunity to scrutinise use of the additional freedoms and flexibilities under the new arrangements. This Policy Statement was submitted and approved by the Full Council at its meeting in March 2010 within section 9 of the Budget Setting report.

[2] Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2008 – SI 2008/404

7. FINANCIAL IMPLICATIONS

7.1 Financial implications are set out within the report.

8. DIVERSITY IMPLICATIONS

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

9. LEGAL IMPLICATIONS

9.1 Guidance has been issued under s21 (IA) of the Local Government Act 2003 (the '2003 Act') on how to determine the level of prudent provision. Authorities are required by Section 21 (B) to have regard to this guidance.

9.2 Under regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) authorities have significant discretion in determining their Minimum Revenue Provision but, as a safeguard, the guidance issued under the 2003 Act recommends the formulation of a plan or strategy which should be considered by the whole Council. This mirrors the existing requirement to report to Council on the prudential borrowing limit and investment policy. The Local Authorities (Functions and Responsibilities) (England) (Amendment) Regulations 2000 have been amended to reflect that the formulation of such a plan or strategy should not be the sole responsibility of the Executive.

10. BACKGROUND INFORMATION

1. Loans Register.
2. Logotech Loans Management System.
3. Arlingclose reports on treasury management.
4. Aberdeen Asset Management quarterly reports.
5. 2010/11 Budget and Council Tax report – March 2010

11. CONTACT OFFICERS

1. Martin Spriggs, Head of Exchequer and Investments – 020 8937 1472
2. Paul May, Capital Accountant – 020 8937 1568

CLIVE HEAPHY
Director of Finance and Corporate Services

APPENDIX 1

Brent treasury lending list

1 The current loans outstanding **as at 31st March 2011** are:

Name	**Amount £m**	**Yield %**	**Lending Date**	**Maturity Date**
Global Treas. Fund (RBS)	9.3	Var.	Call	
Gartmore cash reserve	4.5	Var.	Call	
Northern Trust global fund	0.1	Var.	Call	
Heritable bank	5.0	5.85	15.08.08	14/11/08
Glitnir	5.0	5.85	15.09.08	12/12/08
Skipton BS	5.0	6.48	01.07.08	01/07/11
RBS	5.0	Var.	22.09.08	22/09/11
Total	**33.9**			

Brent has also invested £23.55m with an external manager, Aberdeen Asset Manager, 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:-

Name	**Amount £m**	**Yield %**	**Maturity Date**
Abbey National CD	3.15	1.44	18.10.11
Abbey National CD	1.2	0.00	24.11.11
Barclays Bank CD	2.7	1.45	01.08.11
Barclays Bank CD	1.5	1.42	14.10.11
Clydesdale Bank CD	3.5	0.00	24.05.11
Lloyds TSB CD	1.5	0.00	03.08.11
Lloyds TSB CD	3.0	1.48	05.12.11
Nationwide BS CD	2.25	1.5	22.02.12
RBOS CD	2.3	0.00	03.08.11
RBOS CD	2.35	1.51	06.02.12
Accrued interest	0.1		
Total	**23.55**		

APPENDIX 2

Brent treasury lending list

2 The current loans outstanding **as at 30th June 2011** are:

Name	Amount £m	Yield %	Lending Date	Maturity Date
Global Treas. Fund (RBS)	6.25		Var. Call	
Gartmore cash reserve	12.0	Var.	Call	
Heritable bank	4.365	5.85	15.08.08	14/11/08
Glitnir	5.0	5.85	15.09.08	12/12/08
Northern Trust global fund	0.1	Var.	Call	
Skipton BS	5.0	6.48	01.07.08	01/07/11
RBS	5.0	Var.	22.09.08	22/09/11
Santander UK	10.0	0.81	03.06.10	01.07.10
Total	**47.715**			

Brent had also invested £23.6m with an external manager, Aberdeen Asset Manager, which had placed the fund in a mixture of certificates of deposit (CDs) and cash. However, details have not been included as the mandate was