Appendix 1

GREATER LONDON AUTHORITY

GROUP TREASURY

Treasury Management Outturn for 2016-17 - LFEPA

Executive Summary:

This report is submitted in accordance with a requirement under the Treasury Management in the Public Services Code of Practice (The Code), issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), which requires the submission of an outturn report on the activities of the Authority's treasury management operation.

Treasury activity has seen the Authority's investments outperform its investment benchmark by 0.27% during 2016-17. Total invested balances have increased from £55.76m at the 31 March 2016 to £64.29m at 31 March 2017.

The Authority's loan borrowing levels have reduced from £92.73m at the 31 March 2016 to £78.73m at 31 March 2017.

All 2016/17 Treasury activity has been within the boundaries and levels set by the Authority in its Treasury Management Strategy Statement on 17 March 2016, Document No. FEP 2576, except during the period 01 April 2016 to 12 April 2016. Further details are provided at paragraphs 3 to 6.

Recommendation:

That the following is noted:

- The 2016/17 Treasury outturn results against the 2016/17 Treasury Management Strategy Statement, as approved on the 17 March 2016, Document No. FEP 2576.

Introduction/Background

1 This report provides details of all investment and borrowing activities for the period from 1 April 2016 to 31 March 2017 and highlights relevant issues currently under consideration by officers. It provides a comparison of the closing investment and debt positions as at 31 March 2017 with the opening position as at 1 April 2016.

2 Under the treasury management shared service arrangement with the GLA, GLA treasury officers carry out the Authority's day to day treasury management function, managing the Authority's investments and borrowing activities. Authority officers provide the GLA with details of the Authority's daily cash flow requirements and monies are only transferred between the Authorities as and when required to match Authority need. This way, surplus funds over and above daily need are continuously held with the Group Investment Syndicate (GIS), the GLA managed vehicle used by the Authority to maximise liquidity and investment return.

Compliance with the 2016/17 Treasury Management Strategy Statement

3 The Director of Finance and Contractual Services confirms that, throughout the period, all treasury activities have been conducted within the parameters of the 2016/17 Treasury Management Strategy Statement (TMSS), alongside best practice suggested by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Central Government, except in respect of the period 1 April 2016 to 12 April 2016.

4 For the period 28 March 2016 to 12 April 2016, the GIS counterparty concentration limits for Lloyds Bank were exceeded. No losses arose from this exception of the TMSS.

5 This exception was fully reported in the 2015/16 Treasury Outturn Report, Document No. FEP2624 and properly considered by the Resources Committee on 25 July 2016 and Authority in its meeting of 29 September 2016.

6 Strategy improvements were implemented during the course of 2016/17 within a revised GIS Investment Strategy, as set out at paragraphs 10 to 12.

The Economic Background

7 The two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23 June and the election of President Trump in the USA on 9 November. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4 August meeting, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

8 In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

9 After the EU referendum, Bank Rate was cut from 0.5% to 0.25% on 4 August and remained at that level for the rest of the year. Market expectations as to the timing of the start of monetary tightening started the year at quarter 3 2018, but then moved back to around the end of 2019 in early August before finishing the year back at quarter 3 2018. Deposit rates continued into the start of 2016/17 at previous depressed levels but then fell during the first two quarters and fell even further after the 4 August MPC meeting resulted in a large tranche of cheap financing being made available to the banking sector by the Bank of England. Rates made a weak recovery towards the end of 2016 but then fell to fresh lows in March 2017.

2016/17 GIS Investment Strategy

10 The TMSS sets out an Annual Investment Strategy; however, in line with best practice set out by DCLG and CIPFA, the TMSS is a 'living document' subject to continual review and revision.

11 The GIS Investment Strategy adopted in the original TMSS for 2016/17 was subject to revision during the year in order to improve fitness for purpose under challenging market conditions, such as those witnessed following the EU referendum. The revised GIS strategy was implemented on 1 October 2016.

12 The key improvements that were encompassed are summarised below:

- Reporting ambiguities relating to breaches are eliminated and the levels of discretion for both breach resolution, suspension of counterparties and use of Credit Default Swap ("CDS") data are now set out clearly.
- Provisions relating to the duties and discretions of external managers are made clear.
- The risk appetite implied by the previous strategy is stated explicitly.
- Practical arrangements for the exercise of the Chief Investment Officer's discretions are set out explicitly along with the arrangements for exercise of discretion in that officer's absence.

Current Treasury Management Position

13 The table below shows the current Treasury management position.

Current Treasury Position	Actual as at 31 March 2016		Actual as at 31 March 2017	
	£m	Rate %	£m	Rate %
External Borrowing				
Long Term Borrowing: PWLB	84.73	4.62	78.73	4.67
Long Term Borrowing: Market Loans	8.00	1.31	0	
Total External Borrowing (A)	92.73	4.89	78.73	4.67
Other Long Term Liabilities				
PFI Liability	44.87		49.28	
Finance Lease liability	18.43		18.43	
Total Other Long Term Liabilities(B)	63.3		67.71	
Total Gross Debt (A+B)	156.03		146.44	
Capital Financing Requirement	173.01		171.52	
Less Other Long Term Liabilities	63.3		67.71	
Underlying Capital Borrowing Requirement (C)	109.71		103.81	
Under/(Over) Borrowing (C-A)	16.98		25.08	
Investments (D)	55.76	0.65	64.29	0.55
Total Net Borrowing (A-D)	36.97		14.44	

14 A further analysis of borrowing and investments is covered in the following section.

Borrowing Outturn

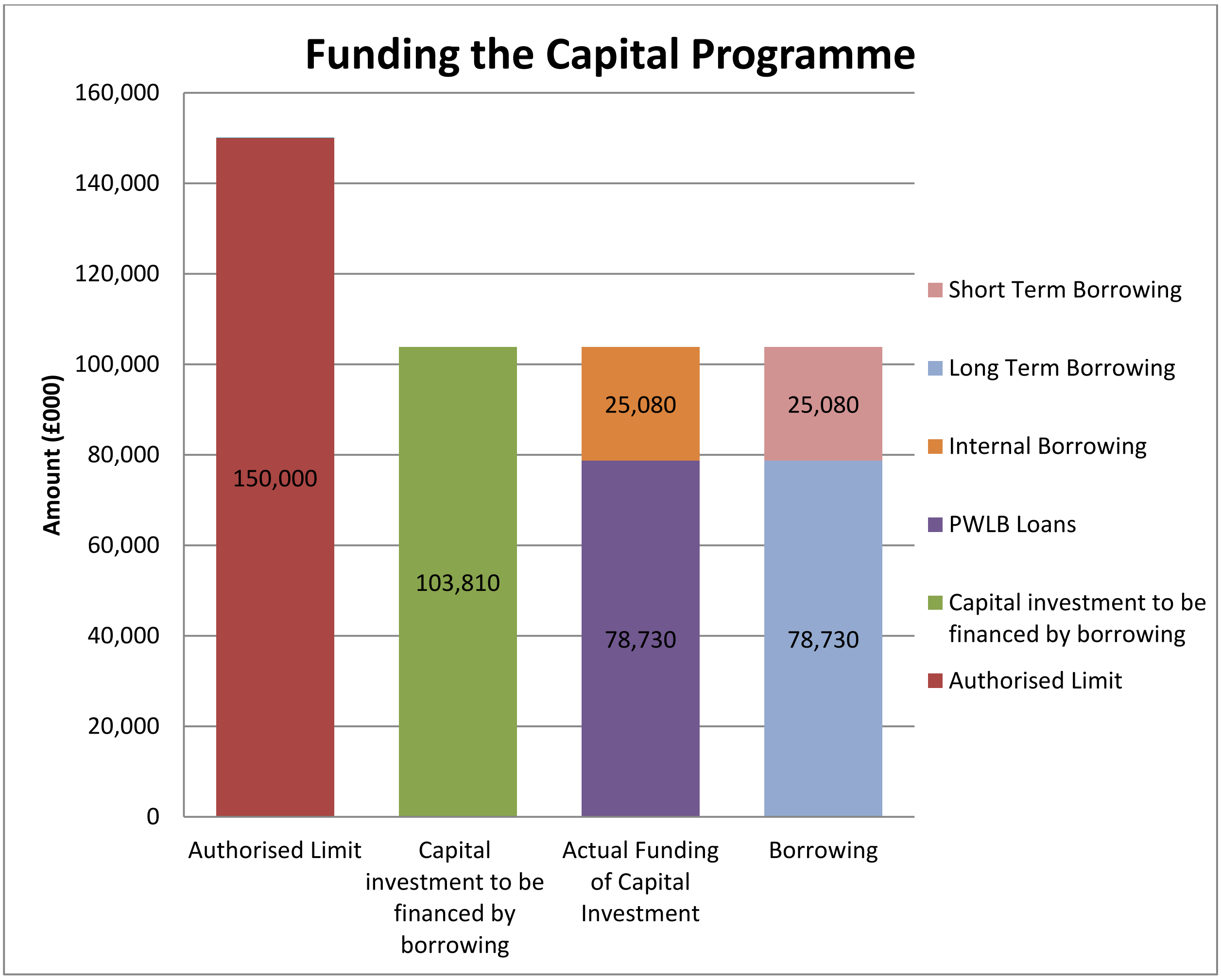
15 The Authority is required to borrow in order to fund spending for its Capital Programme. The amount of new borrowing needed each year is determined by new capital schemes approved and included in the Capital Programme.

16 During 2016/17, the final Private Financing Initiative (PFI) (Dockhead) fire station opened, which increased the PFI liabilities from £44.87m to £49.28m. The PFI arrangement is for a period of 25 years related to new fire stations at Dagenham, Dockhead, Leytonstone, Mitcham, Old Kent Road, Orpington, Plaistow, Purley and Shadwell.

17 No new external loan borrowing was taken out during 2016/17. £14m of external loan borrowing was repaid, reducing the total borrowing to £78.73m

18 No rescheduling of borrowing was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

19 The graph below compares the maximum the Authority could borrow in 2016-17 with the ‘Capital Investment to be financed by borrowing’ at 31 March 2017 and the actual position of how this is being financed at 31 March 2017. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.



20 The graph shows that the Authority’s current capital investment that is being funded via borrowing, as at the 31 March 2017, is £103.81m, which is £46.19m below the Authorised Borrowing Limit set for the Authority at the start of the year.

21 In addition, the graph shows how the Authority is currently funding its borrowing requirement. As at 31 March 2017, the Authority was using £25.08m of internal borrowing to finance capital investment. Internal borrowing is the use of the Authority’s surplus cash to finance the borrowing liability instead of borrowing externally.

Investment Governance

22 The Authority’s short term cash balances are invested through the GLA Group Investment Syndicate (GIS). Current GIS participants are the Greater London Authority (GLA), the London Fire and Emergency Planning Authority (LFEPA), the London Legacy Development Corporation (LLDC), the London Pensions Fund Authority (LPFA), and the Mayor’s Office for Policing and Crime (MOPAC), with the respective Chief Financial Officers of each GIS participant jointly controlling the GIS.

23 Pooling resources allows the Group Treasury team to make larger individual transactions and exploit the greater stability of pooled cash flows to obtain better returns. A risk sharing agreement ensures risk and reward relating to each instrument within the jointly controlled portfolio are shared in direct proportion to each participant's investment.

24 Investments are made in line with a common GIS Investment Strategy, which includes a requirement to maintain a weighted average maturity (WAM), which does not exceed three months, and for each participant to specify a portion of their investment to remain immediately accessible.

25 Additionally, the Authority may invest sums independently of the GIS, for instance if the Authority identifies balances which are available for longer term investment. Such investments must remain within the parameters of the GIS Investment Strategy, except that there shall be no requirement to maintain a weighted average maturity which does not exceed three months. However, each participant can place a limit on the duration of these longer term investments. For 2016/17, the Authority opted not to enter into any investments longer than 364 days in its own name, wishing to limit counterparty risk and liquidity risk.

26 The Authority's TMSS adheres to the CIPFA Prudential Code investment principle of placing security above liquidity and investment yield and then placing liquidity above investment yield. As such, the Authority maintains a low risk appetite consistent with good stewardship of public funds.

Investment Outturn

27 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decision to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are year-end investment balances.

Core Funds and Expected Investment Balances

	Actual as at the 31st March 2016 £m	Actual as at the 31st March 2017 £m
Fund balances/reserves	33.05	37.07
Provisions	7.23	4.78
Other	28.79	27.54
Total Core Funds	69.07	69.39
Working Capital Surplus	3.67	19.98
Under/(over) borrowing	16.98	25.08
Investments	55.76	64.29

28 Investment balances as at 31 March 2017 were £64.29m, this being an increase of £8.53m over year-end balances as at 31 March 2016.

29 The Authority has outperformed its investment benchmark by 0.27% during 2016/17. It achieved a cumulative weighted average yield of 0.55% on daily balances against a cumulative weighted average 3 month LIBID of 0.28%. Throughout the period, the Authority maintained its liquidity target of a weighted average maturity (WAM) of not more than 3 months.

30 Investment performance therefore reflects the success of the decision to place investments in-house through the GLA GIS.

31 Methods used by the Group Treasury team during the year to manage performance have included:

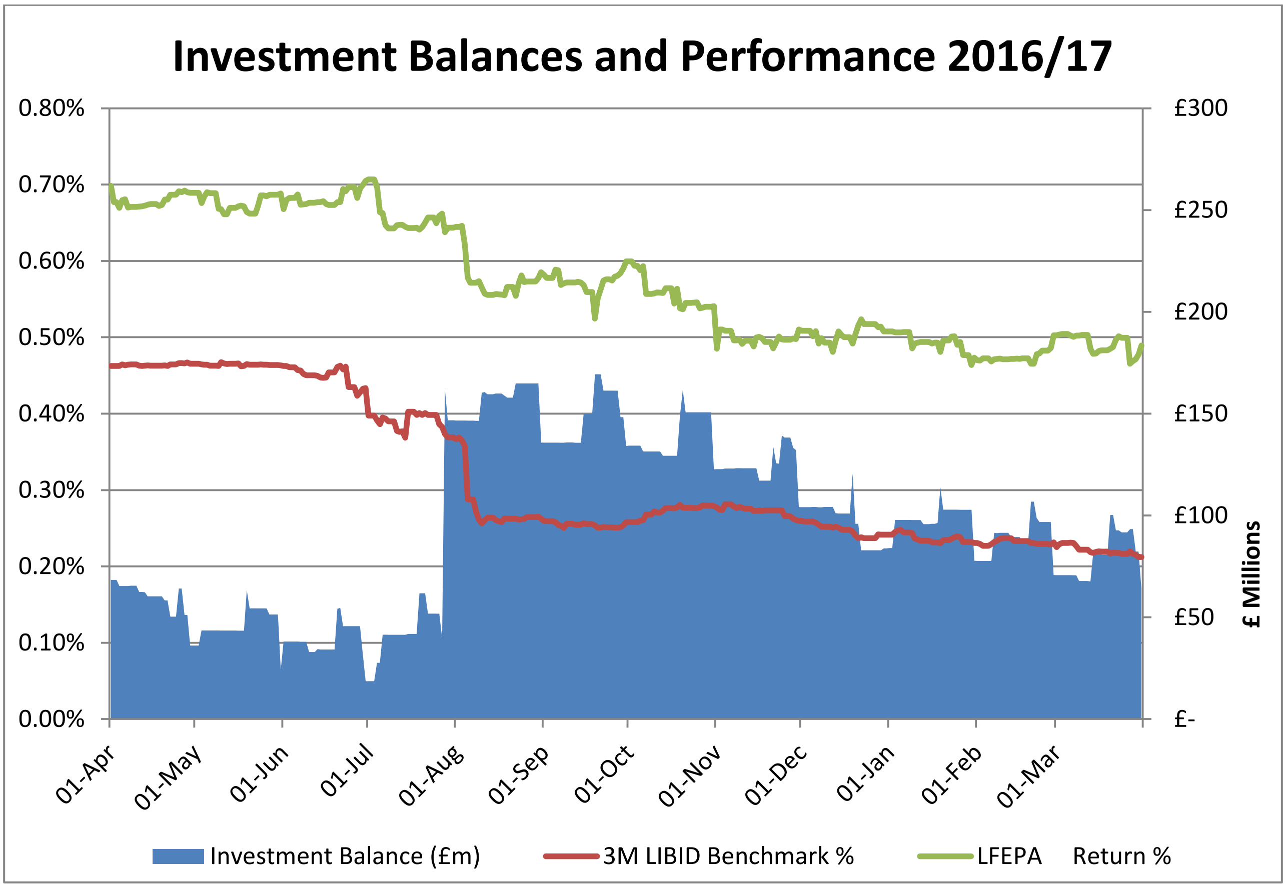
a. Using the strength of the GIS's £2.2bn investment balances to obtain higher than average rates without increasing risk

b. Creating a well-diversified portfolio by country, by counterparty and by credit rating.

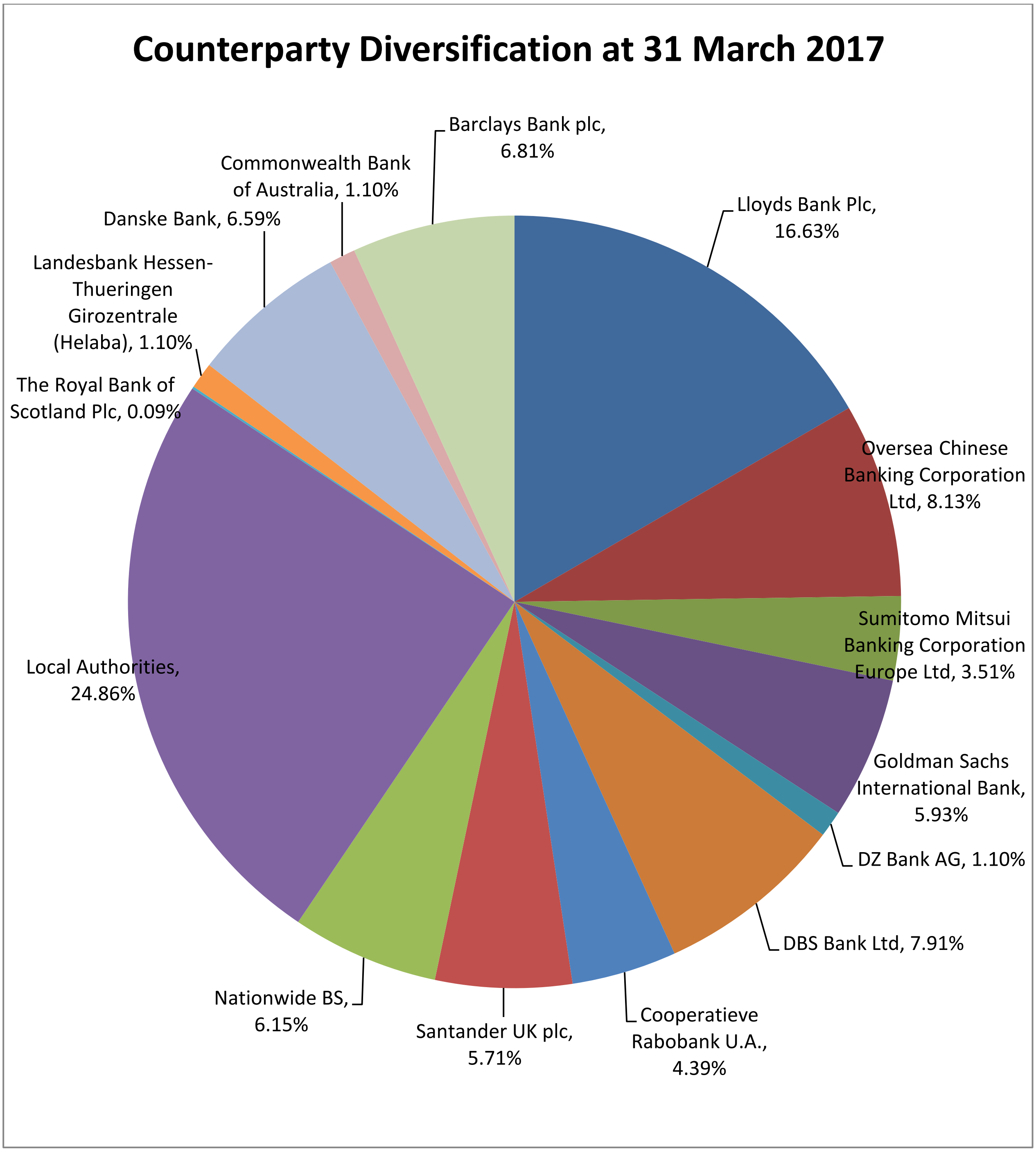
c. Seeking to invest in higher yielding longer dated instruments, while keeping the WAM within the GIS Investment Strategy requirement that the WAM should not exceed 3 months.

d. Monitoring market activity and proactively seizing investment opportunities

32 The following graph shows the outperformance described above, alongside the Authority's investment balances for the period. Fluctuations in balances reflect changes in cash flow needs over the year, but throughout 2016/17 there was circa £20m of cash balances which were not required for daily needs and therefore could be regarded as 'core' cash and available for investment throughout the year.



33 In addition, that the investment portfolio is well diversified is demonstrated in the piechart below



Treasury Management Budget

34 The table below compares the Treasury management budget with previous year.

Treasury Management Budget	Actual as at the 31st March 2016 £m	Actual as at the 31st March 2017 £m
Interest payable	8.64	10.08
Interest Receivable	-0.55	-0.54
Minimum Revenue Provision	6.36	7.01

Total	14.68	14.45

35 The increase in interest payable and minimum revenue provision between years reflects the completion of PFI property lease agreements during the year. Interest receivable is holding up well in a low interest rate environment and this is partly because of increased investment balances.

CIPFA Prudential Code Indicators and Treasury Management Limits

Background

36 The Prudential Code has been developed by CIPFA. The Code has a central role in capital finance decisions, including borrowing for capital investment. Its key objectives are to provide a framework for local authority capital finance that will ensure for individual local authorities that capital expenditure plans are affordable; all external borrowing and other long-term liabilities are within prudent and sustainable levels and that treasury management decisions are taken in accordance with good professional practice.

37 The Prudential Code also has the objective of being consistent with and supporting local strategic planning, local asset management planning and proper option appraisal.

38 Any such framework for the internal control and self-management of capital finance must therefore deal with all three of the following elements:

a. Capital expenditure plans

b. External debt

c. Treasury Management

39 To ensure compliance with the Code in relation to the above elements, the Authority is required to set and monitor a number of Prudential Indicators. The setting of these Prudential Indicators is a circular rather than a linear process. For example, the level of external debt will follow on from the Authority's capital plans, revenue forecast and treasury management strategy. However, if initial estimates would result in outcomes that would not be affordable or prudent, then plans for capital and/or revenue are reconsidered.

40 These Prudential Indicators are set out below and reviewed by officers for compliance.

Capital Expenditure

41 Capital expenditure results from the approved capital spending plan and proposed borrowing limits. It is the key driver of Treasury Management activity.

42 All capital expenditure is stated, not just that covered by borrowing.

Capital Expenditure

	Actual 2015/16 £m	TMSS Forecast to 31st March 2017 £m	Actual 2016/17 £m	2016-17 Variance between Forecast and Actual £m

Total Capital Expenditure	43.91	39.4	23.89	-15.51

43 The capital expenditure for 2016/17, at £23.89m (includes £5.5m PFI lease) was £15.51m less than that expected at the start of the year. Details of the capital underspend are shown in the financial outturn report on the same agenda.

Capital Financing Requirement

44 The capital financing requirement is an indicator of the underlying need to borrow for capital purposes. It is the total historical outstanding capital expenditure which has not yet been paid for from either revenue or capital resource.

45 Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

46 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual charge which broadly reduces the borrowing in line with each assets life.

47 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of scheme include a borrowing facility and so the Authority is not required to separately borrow for these schemes.

48 This borrowing is not associated with particular items or types of capital expenditure.

Capital Financing Requirement (CFR)

	Actual 2015/16 £m	TMSS Forecast to 31st March 2017 £m	Actual 2016/17 £m	2016-17 Variance between Forecast and Actual £m
Total CFR	173.01	171.6	171.5	-0.1

External Debt Prudential Indicators

Authorised Limit for External Debt

49 The authorised limit is the expected maximum borrowing needed with some headroom for unexpected developments such as unusual cash movements

50 For the purposes of the Prudential Code borrowing is distinguished from other long term liabilities.

51 The authorised limit is the statutory limit that is determined, by the Mayor in consultation with the Assembly, under section 3 (1) of the Local Government Act 2003. It is intended to be an absolute ceiling which cannot be exceeded, except as provided under section 5 of the Local Government Act 2003, where payments expected but not yet received can temporarily result in the limit being exceeded, provided the original setting of the limit had not taken into account any delay in receipt of the payment.

Authorised Limit for External Debt	2016-17 Authorised Limit £m	Actual External Debt as at 31 March 2017 £m	Headroom £m
Borrowing	150	78.73	71.27
Other long term liabilities	75	67.71	7.29
Total	225	146.44	78.56

52 Actual external debt is not directly comparable to the authorised limit, since the actual external debt reflects the position at one point in time, whereas the authorised limit is set as a ceiling for the whole year. Notwithstanding this, the borrowing is within acceptable limits.

Operational Boundary for External Debt

53 The operational boundary is based on the same estimates as the authorised limit. However, it reflects an estimate1of the most likely prudent but not worst case scenario. It equates to the maximum level of external debt under the capital spending plans approved by the Mayor and excludes the headroom included within the authorised limit.

54 The operational boundary is set as a warning signal that external debt has reached a level nearing the authorised limit and must be monitored carefully. It is probably not significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant, requiring further investigation and action as appropriate.

Authorised Limit for Operational Boundary	2016-17 Operational Boundary £m	Actual External Debt as at 31 March 2017 £m	Headroom £m
Borrowing	145	78.73	66.27
Other long term liabilities	75	67.71	7.29
Total	220	146.44	73.56

55 Actual external debt is not directly comparable to the operational boundary, since the actual external debt reflects the position at one point in time, whereas the operational boundary is set as a ceiling for the whole year. Notwithstanding this, the borrowing is within acceptable limits.

Gross Debt and the Capital Financing Requirement

56 This is a key indicator of prudence seeking to identify whether or not a Local Authority’s financial strategy is prudent and sustainable by measuring the extent to which a Local Authority is using borrowing to fund revenue expenditure in the short and medium term. Since financing costs have to be repaid from revenue, borrowing to fund revenue expenditure may be affordable in the short term, but not in the medium term. It therefore follows that in the medium term borrowing should only be funding capital expenditure and this indicator seeks to check that this is so, by identifying that debt does not, except in the

short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. In making this comparison between gross debt and the CFR, CIPFA guidance provides that, if in any of these years, there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR which is used for comparison with the gross external debt.

57 For the purposes of the Prudential Code, gross debt refers to the sum of borrowing and other long term liabilities.

Gross Debt and the Capital Financing Requirement (CFR)

Actual External Debt as at 31 March 2017 £m	Preceding Year CFR £m	2016-17 Estimated Additional CFR £m	2017-18 Estimated Additional CFR £m	2018-19 Estimated Additional CFR £m	Total CFR over 4 years £m	Amount Gross Debt < Total CFR over 4 years £m
146.44	173.02	-1.42	12.7	-5.8	178.5	32.06

58 Gross debt, as at 31 March 2017, is £32.06m less than the estimated total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This indicates that the Authority's current financial strategy is prudent and sustainable, in that borrowing is only used to fund capital expenditure in the medium term.

Affordability Prudential Indicators

<u>Ratio of Financing Costs to Net Revenue Stream</u>

59 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

60 The aim of using net revenue stream is to identify the amounts to be met from government grants and taxpayers and hence excludes capital grants, contributions and donated assets. It is also net of contributions from (or to) reserves and balances.

Financing Costs to Net Revenue Stream	Actual as at the 31st March 2016 %	TMSS Forecast to March 2017 %	Actual as at the 31st March 2017 %	2016-17 Variance between Forecast and Year End Actual %
Total	2.60	4.50	2.58	1.92

61 Financing costs to net revenue stream are in line with expectations.

<u>Incremental Impact of Capital Investment Decisions on the Council Tax</u>

62 This indicator measures the changes in the council tax as a result of incremental changes in capital investment decisions.

63 It allows the effect of the totality of the Authority's plans to be considered at budget setting time and the achievement of these plans to be assessed at year end.

64 The Authority's capital investment decisions have had no financial impact on the Council Tax payer in 2016/17, having been fully contained within agreed budgets.

Treasury Management Prudential Indicator

65 The Treasury Management Prudential Indicator requires the adoption of the latest version of the CIPFA Code of Practice for Treasury Management in the Public Services.

66 The Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

Treasury Management Limits on Activity

<u>Fixed and Variable Rate Interest Rates Exposure</u>

67 The following technical prudential indicators reflect the Authority's exposure to changing interest rates.

Fixed rate ratio:

$$\frac{\text{(Fixed rate borrowing* less Fixed rate investments*)}}{\text{Total Borrowing less Total Investments}}$$

Variable rate ratio:

$$\frac{\text{(Variable rate borrowing** less Variable rate investments**)}}{\text{Total Borrowing less Total Investments}}$$

*Defined as greater than 1 year to run to maturity
**Defined as less than 1 year to run to maturity

In consequence of the formulae above, the sum of the two indicators must be 100%

68 To achieve certainty over its borrowing costs in support of prudent long term planning, the Authority has only ever entered into fixed rate loans; however, concerns over liquidity and credit risk mean that in practice all the Authority's investments mature within one year so are categorised as variable rate. The fixed rate ratio is 504% and the variable rate ratio is therefore -404%. If the variable rate ratio were positive, this would indicate that fluctuating rates could increase borrowing costs without being matched by increased investment income.

<u>Limits for Maturity Structure of Borrowing</u>

69 Local Authorities are exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. The maturity structure of borrowing indicator is designed to assist Authorities in avoiding large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. For each maturity period an upper and lower limit is set. This indicator is calculated as the amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate. For the purposes of this indicator only, all borrowing is treated as fixed rate.

Limits for Maturity Structure of Borrowing	TMSS Forecast to March 2017		Actual as at the 31st March 2016	Actual as at the 31st March 2017
	Upper Limit	Lower Limit		
	%	%	%	%
Under 12 months	20	0	15	7
12 months and within 24 months	20	0	6	7
24 months and within 5 years	50	0	19	18
5 years and within 10 years	75	0	22	22
10 years and above	90	25	38	46

70 The above table shows that the Authority has a risk appropriate dispersion of debt over the years.

Limits for Principal Sums Invested for Periods Longer than 364 days

71 This indicator seeks to contain the risk inherent in the maturity structure of an Authority's investment portfolio, since investing too much for too long could

72 adversely impact on the Authority's liquidity and in turn its ability to meet its payment obligations and

73 also lead to the loss of some of its principal if it is forced to seek early repayment or redemption of principal sums invested

74 Under this indicator the Local Authority is therefore required to set an upper limit for each financial year period for the maturing of its long term investments.

75 The Authority has set an upper limit of £0.00, although this limit does not apply to externally managed funds or to pooled monies within the GIS. However, whilst the pooled portfolio may contain instruments maturing in more than 364 days, the average maturity is restricted to 91 days, adding to the reduction of the risk this indicator is seeking to address.

76 Finally, to further protect the liquidity and principal sums of a Local Authority, two additional constraints are placed on Local Authorities

i. The Local Government Act 2003, section 15(1) requires an Authority to have regard to the Department for Communities and Local Government (DCLG) Guidance on Local Government Investments 2010, which requires firstly the achievement of security (protecting the capital sum from loss), then liquidity (keeping the money readily available for expenditure when needed), and then lastly investment yield.

This investment strategy is endorsed by the Prudential Code. The Authority complies with this Guidance by adopting a low risk appetite in its TMSS.

ii. The Prudential Code states that Authorities must not borrow more than or in advance of need purely in order to profit from the investment of the extra sums borrowed. The Authority does not borrow more than or in advance of its need purely to profit from the investment of extra sums borrowed.

New Investments Maturing after 364 days taken between 01/04/16 and 31/03/17

77 No new investment maturing after 364 days was taken during 2016/17.

New Long Term Borrowing taken between 01/04/16 and 31/03/17

78 The Code requires that all long term borrowing is taken out with due consideration to affordability, prudence and sustainability. This is incorporated in the TMSS.

79 No new long term borrowing was taken during 2016/17.