LONDON FIRE
AND EMERGENCY
PLANNING AUTHORITY

Report title

Treasury Management Strategy Statement for 2018/19

Meeting	Date
Resources Committee Authority	16 March 2018 29 March 2018
Report by	**Document Number**
Director Finance and Contractual Services	FEP 2827

Public

Summary

Under Authority Financial Regulations, the Director of Finance and Contractual Services, being the Authority's statutory finance officer, is required to report to the Authority on the Treasury Management Strategy Statement and Annual Investment Strategy it is proposed to adopt in the coming financial year. It is presented to the Resources Committee for review and to the Authority for approval.

In addition the Authority is required by statutory regulation to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities, when carrying out its duties under Part 1 of the Local Government Act 2003. The Prudential Code requires the Authority to approve a range of specific Treasury Management indicators. The Authority meets the first prudential indicator in respect of treasury management by having adopted CIPFA's Treasury Management in the Public Services Code of Practice (The TM Code) and Cross-Sectoral Guidance Notes 2011 edition. The additional indicators are shown in the recommendations below.

The TM Code emphasises that responsibility for risk management and control lies within the Authority and cannot be delegated to any outside organisation. It also highlights that those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

The proposed Annual Investment Strategy continues to take a risk averse approach to investment which gives priority to the security of funds over the rate of return. The TM Code advises that Authorities should have regard to all ratings issued by the three main rating agencies considered alongside market and media information. It is proposed that the Authority continue to use the current creditworthiness service from Link Asset Services (formerly Capita Asset Services Treasury Solutions), which uses ratings from all three agencies, which are based on past performance, but by using a scoring system incorporating credit default swap rates provides a forward looking market view. Officers will, as before, monitor market and media intelligence to further inform their assessment of investment counterparties.

The Authority's Investment Strategy authorises the participation in the GLA Group Investment Strategy (GIS).The proposals in this report align the investment strategies of LFEPA and the other member bodies of the GIS in a common approach to treasury management, so far as is possible within individual requirements. This maximises the efficiency available through the Treasury Management service shared with the GLA.

The strategy will require endorsement from and adoption by the London Fire Commissioner (LFC) under new governance arrangements following the abolition of the Authority and the establishment of the new governance arrangements. References to the future actions required of the Authority, its Resources Committee and Members as a result of the adoption of the Strategy should be read as the LFC from 1 April 2018.

Guidance issued by the Secretary of State under section 21 (1A) of the Local Government Act 2003 requires the Authority to approve the proposed Minimum Revenue Provision Policy Statement for 2018/19 in advance of the year.

Recommendations

For Resources Committee

1. That the Resources Committee recommends the Authority approves the contents of the Treasury Management Strategy Statement.

For Authority

2. That the Authority approves the Treasury Management Strategy Statement for 2018/19, including the

    i. Treasury Management Policy Statement (Appendix 1),

    ii. Minimum Revenue Provision Policy Statement (Appendix 2),

    iii. Prudential Code Indicators and Treasury Management Limits (Appendix 3),

    iv. Group Investment Syndicate (GIS) Investment Strategy (Appendix 4)

    v. Treasury Management Practices: Main Principles (Appendix 5)

Introduction/Background

1. The Treasury Management Strategy Statement (TMSS) sets out the Treasury Management activities of the LFEPA for the year 2018/19.

2. This TMSS has been prepared with regard to the following legislation and guidance:

    - The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (The TM Code) and associated Guidance Notes

    - The CIPFA Prudential Code for Capital Finance in Local Authorities and associated Guidance Notes

    - The Local Government Act 2003

    - The Department for Communities and Local Government (DCLG) Guidance on Local Government Investments

    - The DCLG Capital Finance Guidance on Minimum Revenue Provision

3. The TM Code defines treasury management activities as:

    'The management of the organisation's investments and cash flows, 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.'

4. This TMSS therefore takes into account the impact of the Authority's Revenue Budget, Medium Term Capital Programme and the Balance Sheet position and covers the following areas:

    - Economic Background

    - Prospects for Interest Rates

    - Forecast Treasury Management Position

    - Borrowing Strategy

    - Policy on Borrowing in Advance of Need

    - Debt Rescheduling

    - Investment Strategy

    - Use of External Service Providers

    - Treasury Training

    - Treasury Management Policy Statement (Appendix 1)

- Minimum Revenue Provision (MRP) Policy Statement (Appendix 2)

- Prudential Code Indicators and Treasury Management Limits (Appendix 3)

- Group Investment Syndicate (GIS) Investment Strategy (Appendix 4)

- Treasury Management Practices: Main Principles (Appendix 5)

5. In covering the above areas, as per its Treasury Management Policy Statement (Appendix 1), the Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Responsibility for risk management and control lies within the Authority and cannot be delegated to any outside organisation.

6. The Treasury Management risks the Authority is exposed to are:

   - Credit and counterparty risk (security of investments)

   - Liquidity risk (inadequate cash resources)

   - Interest and market risk (fluctuations in interest rate levels and thereby in the value of investments)

   - Refinancing risks (impact of debt maturing in future years) and

   - Legal and regulatory and fraud risk (non-compliance with statutory and regulatory requirements, risk of fraud)

7. These risks are further discussed in Appendix 5 (Treasury Management Practices: Main Principles)

8. The Authority formally adopts The TM Code through the following provisions

   i. The Authority will create and maintain as the cornerstones for effective treasury management:

   - a Treasury Management Policy Statement stating the policies, objectives and approach to risk management of its treasury management activities and

   - suitable Treasury Management Practices (TMPs), setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

     The content of the proposed policy statement and TMPs follow the recommendations contained in Sections 6 and 7 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments do not result in the Authority materially deviating from the Code's key principles.

   ii. The Authority will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

iii. The Authority delegates responsibility for the execution and administration of treasury management decisions to the Director of Finance and Contractual Services, who will act in accordance with the organisation's policy statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

iv. The Authority remains responsible for ensuring effective scrutiny of the treasury management strategy and policies.

v. Should there be a need to revise the Treasury Management Strategy; the Treasury Management Policy Statement; the Minimum Revenue Provision Policy Statement; the Prudential Code Indicators and Treasury Management Limits; the GIS Investment Strategy and the Treasury Management Practices at times other than those stated above, then these updates will be submitted to the Authority for approval.

vi. Should the Director of Finance and Contractual Services wish to depart in any material respect from the main principles of the TM Code, the reason should be disclosed, in advance, in a report to the Authority.

9. The main changes in the TMSS 2018/19 as compared to the TMSS 2017/18 are:

- Updated Economic Background (at paragraph 10 below)
- Updated interest rate forecasts (at paragraph 17 below)
- Revised Prudential Indicators and Treasury Management Limits (Appendix 3)

Economic Background

10. Presented below is the economic background prepared by the GIS treasury advisers, Link Asset Services.

11. After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has confounded pessimistic forecasts of weak growth by coming in at 1.8%, only marginally down on the 1.9% rate for 2016. In 2017, quarter 1 came in at +0.3% (+1.8% y/y), quarter 2 +0.3% (+1.5% y/y), quarter 3 +0.4% (+1.5% y/y) and Q4 was +0.5% (+1.5% y/y). The improved performance came from the manufacturing sector which showed a 1.3% increase in Q4 and +3.1% y/y helped by an increase in exports due to the lower value of sterling over the last year and robust economic growth in our main trade partners, the EU and US. It is also notable that there has been a progressive acceleration in total GDP growth during the year which gives ground for optimism looking forward into 2018.

12. While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak. Inflation fell to 3.0% in December.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was

significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

13. At its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

14. However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

15. One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

16. Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

Prospects for Interest Rates

17. The effective management of risk around borrowing and investments and cash flow management decisions includes understanding interest rate and inflation rate movements.

18. The Authority has appointed Link Asset Services as its treasury advisor and part of its service is to assist the Authority to formulate a view on interest rates. The following table gives its central view. The PWLB Rates shown are net of the 0.2% 'certainty rate' discount.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Forecast Treasury Management Position

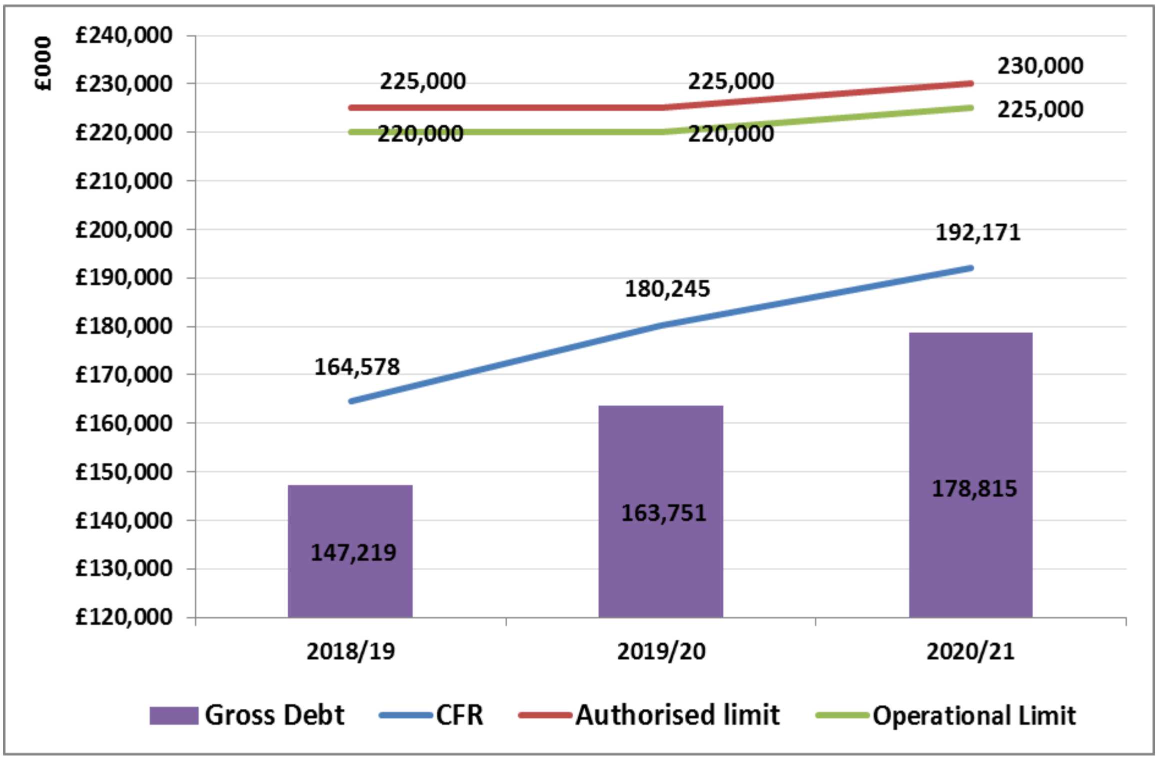
19. The Authority's forward treasury portfolio position is summarised below. The table shows the actual external borrowing (the treasury management operations) against the underlying capital borrowing requirement (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Forecast Treasury Position

Forecast Treasury Position	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
External Borrowing			
Borrowing at 1 April	147.1	141.1	151.6
Change in borrowing	(6.0)	10.5	15.0
Borrowing at 31 March (A)	141.1	151.6	166.6
Underlying capital borrowing requirement	158.4	169.0	183.2
Under/(over) borrowing	17.3	17.4	16.6
Investments			
Investments at 31 March (B)	55.5	56.3	41.5
Change in investments	(7.3)	0.8	(14.8)
Net Borrowing (A-B)	85.6	95.3	125.1

20. Within the set of prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well defined limits. One of these is that the Authority needs to ensure that its gross borrowing does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for the current year and the next two financial years. This key prudential indicator is referred to as 'gross debt and the capital financing requirement'. It allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes, except to cover short term cash flows. 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.

21. The following graph shows projections of the CFR and borrowing, together with Authorised and Operational Boundary Limits.



The Director of Finance and Contractual Services reports that the Authority complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the proposals in the Authority's budget report on the same agenda.

Borrowing Strategy

Delegation/Authorisation

22. The arrangements for borrowing, including the selection and the type and structure of debt instruments, are delegated to the Director of Finance and Contractual Services, provided no decision contravenes the limits set out in the prevailing TMSS.

23. On the basis of the above, the Director of Finance and Contractual Services is

- authorised to approve borrowing by the Authority, for the purposes of financing capital expenditure and subject to the necessary statutory provisions, provided that the Authorised Limit, determined by the Mayor for the Authority, is not exceeded.

- authorised to make use of cash balances to fund internal borrowing when it is considered advantageous, provided the Authorised Limit, determined by the Mayor for the Authority, is not exceeded.

- authorised to borrow temporarily within the Authorised Limit, where this represents prudent management of the Authority's affairs. As an example, where a cash flow requirement is short-lived, the opportunity cost of withdrawing or otherwise liquidating investments may exceed that of temporary borrowing. In such circumstances, borrowing may be the prudent action. A nominated Committee/Board should be informed of any temporary borrowing within the agreed reporting cycle.

- authorised to borrow temporarily above the Authorised Limit where, and only where the amount of the increased limit represents the amount of any delayed payment which is due to the Authority and has not been received on the due date, and such delay has not already been provided for in the Authorised Limit, under the provisions of Section 5 of the Local Government Act 2003. The Resources Committee should be informed within agreed reporting intervals of any temporary borrowing.

24. All borrowing decisions should be reported to the relevant Committee/Board at the first opportunity within the Treasury Management cycle.

Borrowing and Risk

25. It is proposed that the Authority's approach to Treasury Management continues to be risk adverse; borrowings will be taken on fixed rates from the Public Works Loan Board (PWLB) or from other approved sources of financing. Variable rate long term borrowing may only be undertaken where there are proportionate, dedicated income streams which would vary in accordance to any proposed variable rate instruments.

26. Officers will consider the use of Finance Leases where it is demonstrated to be advantageous to the Authority to use such arrangements, for planned acquisition of non-fixed plant, equipment and/or machinery.

Borrowing and Interest Rates

27. Against the background and the risks within economic forecast, caution will be adopted with the 2018/19 treasury operations. The Director of Finance and Contractual Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.:

Internal Borrowing

28. When using cash balances to fund internal borrowing, the Authority acknowledges that this may reduce credit risk and short term net financing costs. However, any decision to undertake internal borrowing will be tempered by the following considerations:

    - The Authority must maintain sufficient liquidity to be certain of meeting existing borrowing and other obligations

    - The measures set out in the investment strategy below substantially control credit risk

    - The materiality of such risks should be considered in the light of the long term financial consequences of sub-optimal borrowing decisions

    - Agreements with central government specifying particular levels of borrowing

29. The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt, as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively higher.

Short Term Borrowing Approach

30. The Authority may borrow temporarily (i.e. for less than 12 months) to cover cash flow needs. Total borrowings will not exceed the authorised limit except possibly by an amount equal to any sum due to but not yet received by the Authority, as permitted by section 5 of the Local Government Act 2003

Policy on Borrowing in Advance of Need

31. The Authority will not borrow more than or in advance of need purely to profit from the investment of the surplus borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

32. In determining whether borrowing will be undertaken in advance of need the Authority will:

    i. Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets are considered to be affordable and are within the forward approved Capital financing requirement estimate

    ii. Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow

    iii. Consider the merits and demerits of alternative forms of funding , including funding from revenue, leasing and private partnerships and

    iv. Consider the alternative interest rates bases available, the most appropriate periods to fund and repayment profiles to use.

33. Over the next 12 months the economic consensus is that investment rates are expected to remain significantly below borrowing rates. However, short-term avoidance of costs by postponing borrowing in 2018/19 will also be weighed against the potential for incurring additional long-term costs by having to enter into new external borrowing in later years, when long-term rates are expected to be higher.

Debt Rescheduling

34. Given short term borrowing rates are likely to be cheaper than longer term fixed interest rates, decisions may be taken to restructure the debt portfolio, by switching from long term debt to short term debt through the early redemption or replacement of loans, so as to either increase long term affordability or adjust maturity profiles for the purposes of managing liquidity and interest rate risks. Such rescheduling decisions will be reported to the Resources Committee at the first opportunity within the treasury management reporting cycle.

35. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

36. PWLB pricing exaggerates the spread between the rate of new loans and the rate used to calculate premiums or discounts on early redemption. This means that there are far fewer opportunities for restructuring than was historically the case, due to prohibitively expensive premia in relation to achievable savings. This emphasises the importance of attempting to optimise maturity profiles at the point of entering into borrowings.

Investment Strategy

37. The Authority maintains a low risk appetite consistent with good stewardship of public funds. At the forefront of its thinking is the principle of Security before Liquidity and Liquidity before Yield (SLY). Cash flow forecasts and prevailing market conditions determine the maximum possible prudent maturities for investments and credit considerations are used to select counterparties with whom to transact. Investments are managed in such a way as to make losses at the portfolio level extremely unlikely, while capturing the optimum return within these constraints.

38. The Authority will continually develop its investment risk methodologies with regard to advice from external advisors, relevant developments in the market and academia, benchmarking techniques and approaches employed by the Credit Ratings Agencies. These Agencies are currently Fitch, Moodys, and Standard and Poor's and their credit ratings will be monitored on a daily basis with appropriate action taken when these ratings change.

39. The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Authority will not engage in such activity.

40. 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 estimates of the year end investment balances.

Core Funds and Expected Investment Balances

	2018/19 Estimate £m	2019/20 Estimate £m	2012/21 Estimate £m
Fund balances/reserves	45.8	34.4	30.1
Provisions	7.0	6.0	6.0
Other	0.0	13.3	2.0
Total Core Funds	52.8	53.7	38.1
Add Working Capital Surplus*	20.0	20.0	20.0
Less Under/(over) borrowing	17.3	17.4	16.6
Expected Investments	55.5	56.3	41.5

*Working capital balances shown are estimated year end and so these balances may be higher mid year

41. This Strategy effectively constitutes the Authority's Annual Investment Strategy, which should be prepared and approved before the start of each financial year, with approval by the Authority. This GIS Investment Strategy is currently under review by all the current participants of the GIS and the Board is presented with the latest version.

2018/19 GIS Investment Strategy

42. The GIS Investment Strategy is considered and agreed by participants. A common approach permits maximum efficiency of the shared group service.

43. Where funds are placed in pooled vehicles such as Money Market Funds (MMFs), each MMF is only an approved counterparty while the underlying investments are instruments of the kinds listed in Appendix 4. Variation between a MMF's list of approved counterparties and the approved counterparties of the LFEPA is permissible, at the discretion of the Director of Finance and Contractual Services, providing the MMF's own rating meets the criteria of Appendix 4.

44. Additionally, the Director of Finance and Contractual Services may from time to time instruct the GLA Treasury team to invest sums independently of the GIS, for instance, if the Authority identifies balances which are available for longer term investment, after proper consideration of expected future cash flows, as at the time of investment. It is proposed that the Authority adopt an identical set of parameters for such investments as those detailed in Appendix 4, except that there shall be no requirement to maintain a weighted average maturity of no greater than three months. However, regard must always be given to the Treasury Managements Limit 'Limits for Principal Sums Invested for Periods Longer than 364 Days' (Appendix 3 section 6.3).

45. There are currently no plans to invest for periods longer than one year in the Authority's own name, because the Authority does not expect to have core cash balances which permit such investment durations. The Treasury Management Limit 'Limits for Principal Sums Invested for Periods Longer than 364 Days' is therefore set at zero. However in light of potential capital receipts this position will be kept under review and any move to invest funds long-term will be put to members for consideration. (This limit does not apply to externally managed funds or to pooled monies within the Group Investment Syndicate, providing the weighted average maturity of investments does not exceed 3 months): See Appendix 3 Section 6.3.

46. A GLA Group Responsible Investment Statement is included in the 2018/19 GIS Investment Strategy in Appendix 5. This addresses ethical considerations when placing investments.

47. Whilst the Authority sets its Annual Investment Strategy at the start of each financial year, this need not be a once-a-year event, and the initial investment strategy may be replaced by a revised Strategy, at any time during the year, on one or more occasions, subject to the approval of the Authority. All Investment Strategies approved by the Authority will be made available to the public free of charge, on print or online.

Treasury Management Budget

48. The Table below provides a breakdown of the treasury management budget

Treasury Management Budget

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Interest payable	3.52	3.59	4.01
Interest Receivable	(0.40)	(0.40)	(0.40)
Minimum Revenue Provision	7.05	8.13	9.47
Total	10.17	11.32	13.08

Use of External Service Providers

49. The LFEPA uses Link Asset Services (following a name change formerly Capita Asset Services) as its external treasury management advisor under a joint arrangement with the Greater London Authority. Whilst recognising the specialist skills and resources such advisors can provide, the LFEPA recognises that responsibility for treasury management decisions remains wholly with the organisation and will ensure that undue reliance is not placed upon external service providers. LFEPA monitors and maintains the quality of this service by regular review and assessment.

50. Link Asset Services currently provide;

- consultancy services to support the Authority's treasury operation
- attend two strategy meetings per annum to review the Authority's financial position having regard to its objectives, strategy, current financial circumstances, assets and liabilities.
- interest rate forecast and advise on the formulation of suitable borrowing and investment strategies
- forecasts of movements in PWLB rates which affect the timing of funding with fixed rate debt, conversion of variable rate debt to fixed and the conversion of fixed rate debt to variable
- regular updates on economic and political changes which may impact on and require modification to borrowing and investment strategies
- advice on debt rescheduling, funding policy, volatility and maturity profile analysis
- advice and weekly reports on counterparty creditworthiness, including provision of prudent parameters established in the light of information from the UK's leading credit rating agencies, the credit default swaps market and various other analyst and associations
- reporting templates

51. The LFEPA does not currently employ any external fund managers, however in the event of such an appointment, appointees will comply with this and subsequent Treasury Strategies. In addition, before any appointment is made, a fully costed appraisal would be performed and approval from the Authority obtained.

52. RBS plc are the LFEPA's bankers and continue to provide a competitive service under an annual rolling contract.

53. The GLA Investment Manager, under the GIS Investment Strategy, uses King and Shaxson Limited as a custodian of the Authority's tradeable instruments (such as Treasury Bills) with HSBC as the sub-custodian. The GLA's policy is that any custodian (or, instead, sub-custodian) shall meet the GLA's credit criteria for 12 month investments (prior to Credit Default Swaps Market or other temporary adjustments). The GLA Investment Manager shall also use a properly appointed custodian to support any RMBS investments as part of GIS2.

Treasury Training

54. The TM Code requires that those charged with governance with responsibility for treasury management receive adequate training in treasury management. Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

55. Link Asset Services run training events regularly which are attended by Treasury officers. In addition, Treasury officers attend national forums and practitioner user groups.

56. Notwithstanding the above, the training needs of Treasury officers and those charged with governance are periodically reviewed and updated as necessary.

Head of Legal and Democratic Services comments

57. The relevant legal powers and requirements are set out in the body of the report. Section 127 of the Greater London Authority Act 1999 provides that the Authority is to make arrangements for the proper administration of its financial affairs and shall secure that one of its officers (its "chief finance officer") has responsibility for the administration of those affairs. The Director of Finance and Contractual Services is the chief finance officer for the Authority and this report sets out the strategy and arrangements by which she proposes to address the Authority's responsibilities in relation to its Treasury functions.

Director of Finance and Contractual Services comments

58. This report is presented by the Director of Finance and Contractual services and there are no further comments.

Sustainable Development implications

59. There are no sustainable development implications

Staff Side Consultations undertaken

60. There are no direct implications associated with the contents of this report requiring consultation.

Equalities implications

61. There are no direct equalities implication associated with the contents of this report.

List of Appendices to this report:

1. Treasury Management Policy Statement (Appendix 1)
2. Minimum Revenue Provision (MRP) Policy Statement (Appendix 2)
3. Prudential Code Indicators and Treasury Management Limits (Appendix 3)
4. Group Investment Syndicate (GIS) Investment Strategy (Appendix 4)
5. Treasury Management Practices: Main Principles (Appendix 5)

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985

List of background documents

1. Local Government Act 2003
2. The Prudential Code (Revised 2011)
3. The Prudential Code Guidance Notes (Revised 2013)
4. Local Authorities (Capital Finance and Accounting)(England) Regulations 2003
5. Authority Financial Regulations
6. CIPFA Code of Practice for Treasury Management in Public Services and Cross-Sectoral Guidance Notes (Edition 2011)
7. CIPFA Treasury Management - Guidance Notes for Local Authorities Including Police Authorities and Fire Authorities (Edition 2011)
8. PWLB Circular no. 149, 4 January 2011 Methodology for Calculating Interest Rates On PWLB Fixed Rate and Variable Rate Loans
9. Bank of England Monetary Policy Committee - Monthly Interest Rate Setting Bulletins
10. The Department for Communities and Local Government (DCLG) Guidance on Local Government Investment
11. The DCLG Capital Finance Guidance on Minimum Revenue Provision

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Appendix 1: Treasury Management Policy Statement

1. Policy Statement

1.1 This policy statement is in the form recommended by the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes, Section 6.

1. The LFEPA defines its treasury management activities as:

   "The management of the Authority's investments and cash flows, 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".

2. The LFEPA regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the LFEPA, and any financial instruments entered into to manage those risks.

3. The LFEPA acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Appendix 2: Minimum Revenue Provision (MRP) Policy Statement

1. Policy Statement

1.1 MRP is the amount out of revenue funding set aside each year as a provision for debt i.e. the provision in respect of capital expenditure financed by borrowing or credit arrangements.

1.2 Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) provides that for the financial year 2007/08 and subsequent financial years, the detailed MRP calculation is to be replaced with the requirement that:

1.3 'A Local Authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent'

1.4 The guidance also recommends that the annual MRP Policy is presented to the Authority for approval before the start of the financial year to which it relates. Any in-year changes must also be submitted to the Authority for approval.

1.5 The recommended statement for LFEPA is set out below:

1. The major proportion of the MRP for 2018/19 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance. Certain expenditure reflected within the debt liability as at 31 March 2018 will under delegated powers be subject to MRP under option 3, which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment of a building, will be related to the estimated life of that building.

2. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Authority. However, the Authority reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

3. As some types of capital expenditure incurred by the Authority are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Appendix 3 CIPFA Prudential Code Indicators and Treasury Management Limits

1. **Background**

1.1 The Prudential Code has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Prudential 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.

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

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

- Capital expenditure plans
- External debt
- Treasury Management

1.4 To ensure compliance with the Prudential 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 forecasts 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.

1.5 Prudential Indicators and Treasury Management Limits must be approved by the Authority and any subsequent changes to these Indicators and Limits must also be approved by the Authority.

1.6 These Prudential Indicators are set out below and reviewed for compliance.

2. **Capital Expenditure**

2.1 <u>Capital Expenditure</u>

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

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

Capital Expenditure

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Capital Expenditure	39.0	47.0	21.4
Financed by:			
Capital receipts	37.7	26.7	0.0
Capital grants/donations	0.0	2.5	0.0
Capital reserves	0.0	0.0	0.0
Revenue	0.0	0.0	0.0
Net financing need for the year	1.3	17.8	21.4

* The capital programme for future years and use of capital receipts is addressed in the budget report on the same agenda.

2.2. Capital Financing Requirement

2.2.1 The capital financing requirement is an indication 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.

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

Capital Financing Requirement (CFR)

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total CFR	158.4	169.0	183.2
Movement in CFR	(5.8)	10.6	14.2
Movement in CFR represented by			
Net financing need for the year (see Capital Expenditure table)	1.3	17.8	21.4
Less Capital receipts to repay borrowing	0.0	0.0	0.0
Less MRP/VRP* and other financing movements	(7.1)	(7.2)	(7.2)
Movement in CFR	(5.8)	10.6	14.2

*The MRP/VRP will include PFI/finance lease annual principal payments

3. External Debt Prudential Indicators

3.1 Authorised Limit for External Debt

3.1.1 The Authorised limit is the expected maximum borrowing needed with some headroom for unexpected developments such as unusual cash movements.

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

3.1.3 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

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	150.0	150.0	155.0
Other long term liabilities	75.0	75.00	75.0
Total	225.0	225.0	230.0

3.1.4 This limit is consistent with the Authority's view on current and future affordability, as advised to the Mayor in the course of consultation.

3.2 Operational Boundary for External Debt

3.2.1 The operational boundary is based on the same estimates as the authorised limit. However, it reflects an estimate of 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.

3.2.2 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.

Operational Boundary for External Debt

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	145.0	145.0	150.0
Other long term liabilities	70.0	70.0	70.0
Total	215.0	215.0	220.0

3.2.3 This limit is consistent with the Authority's view on current and future affordability, as advised to the Mayor in the course of consultation.

3.2.4 Gross Debt and the Capital Financing Requirement

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.

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

	2017/18 Projected £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Gross Debt at 31 March	147.1	141.1	151.6	166.6
Capital Financing Requirement	164.3	158.4	169.0	183.2

4. Affordability Prudential Indicators

4.1 Ratio of Financing Costs to Net Revenue Stream

4.1.1 This indicator compares the total principal and net interest payments on external debt to the overall revenue spending of the authority.

Financing Costs to Net Revenue Stream

	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Total	2.55	2.81	3.20

4.2 Incremental impact of capital investment decisions on the council tax

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

Incremental Impact on Council Tax

	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Council Tax Band D	0.00	0.00	0.00

5. Treasury Management Prudential Indicator

5.1 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.

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

6. Treasury Management Limits on Activity

6.1 Net Borrowing Upper Limits to Fixed and Variable Rate Interest Rates Exposure

6.1.1 The upper limit on interest rate exposure sets an upper limit to exposure to the effects of changes in interest rates. These limits are presented as a percentage of the net principal sum outstanding on the Local Authority's borrowing. The calculation formula is therefore;-

Total Fixed (or Variable Rate) Borrowings less Total Fixed (or Variable Rate) Investments

Divided by

Total Borrowing less Total Investments

Fixed rate calculation:

(Fixed rate borrowing* less Fixed rate investments*)

Divided by

Total Borrowing less Total Investments

*Defined as greater than 1 year to run to maturity

Variable rate calculation:

(Variable rate borrowing** less Variable rate investments**)

Divided by

Total Borrowing less Total Investments

**Defined as less than 1 year to run to maturity, or in the case of Lenders Option, Borrowers Option (LOBO) borrowing, the call date falling within the next 12 months.

Upper limit on interest rate exposure on net debt

	2018/19	2019/20	2020/21
	%	%	%
Fixed rate	100	100	100
Variable rate	75	75	75

6.1.2 These proposed limits will allow officers to move between fixed and variable rate deposits in response to changes in market conditions.

6.2 Limits for Maturity Structure of Borrowing

6.2.1 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 debt that has the same maturity structure and would therefore need to be replaced at the same time. The indicator is calculated as the amount of projected borrowing that is maturing in each period expressed as a percentage of total projected borrowing. For each maturity period an upper and lower limit is set.

Limits for Maturity Structure of Borrowing for 2018/19

	Upper Limit	Lower Limit
	%	%
Under 12 months	20	0
12 months and within 24 months	20	0
24 months and within 5 years	50	0
5 years and within 10 years	75	0
10 years and above	90	25

6.2.2 The maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment. Where the lender has the right to increase the interest rate payable without limit, such as in a LOBO loan, the maturity date will be deemed to be the next call date.

6.3 Limits for Principal Sums Invested for Periods Longer than 364 Days

6.3.1 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

- adversely impact on the Authority's liquidity and in turn its ability to meet its payment obligations and
- also lead to the loss of some of its principal if it is forced to seek early repayment or redemption of principal sums invested.

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

Limits for Principal Sums Invested for Periods Longer than 364 days

	Maximum principal sums invested >364 days		
	2018/19 £m	2019/20 £m	2020/21 £m
Principal sums invested >364 days	0	0	0

6.3.3 This limit does not apply to externally managed funds or to pooled monies within the Group Investment Syndicate, providing the weighted average maturity of investments does not exceed 3 months.

Appendix 4: Investment Strategy 2018/19

(incorporating the GIS Investment Strategy 2018/19 –Appendix 4 part 2)

1. Introduction

1.1 The Authority has a Shared Service Agreement with the GLA, under which the GLA has delegated authority to manage the Authority's investments.

1.2 A two fold approach applies to the management of the Authority's investments under this Shared Service Agreement.

1.3 Cash balances can be invested independently of the GLA Group Investment Syndicate (GIS), in the Authority's own name. This normally arises where the Authority identifies balances which are available for longer term investments

or

Cash balances can be invested through the GLA GIS, in the name of the GIS.

1.4 Cash balances invested in the Authority's own name are subject to the GIS Investment Strategy, except that there is no requirement to maintain a weighted average maturity which does not exceed 3 months.

1.5 Cash balances invested in the name of the GIS are subject to the GIS Investment strategy.

1.6 All Authority investments must therefore fully consider the GIS Investment Strategy. This Strategy is outlined below:

2. GIS Investment Strategy Introduction

2.1 The GIS is a vehicle for investing pooled short term cash balances belonging to 'participants', currently 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). The GLA acts as the Investment Manager under the supervision of the Syndics (the participants' respective chief financial officers).

2.2 On an individual basis, shorter investments can give rise to additional transaction costs and lower returns; but by pooling resources the participants can achieve economies of scale through larger individual transactions; can exploit the greater stability of pooled cash flows to obtain better returns and can achieve greater levels of diversification.

2.3 A risk sharing agreement ensures risk and reward relating to each investment within the jointly controlled portfolio are shared in direct proportion to each participants' investment.

2.4 The Investment Manager (the GLA) operates the GIS cash balances in accordance with the GIS Investment Strategy.

3. GIS Investment Strategy

GIS INVESTMENT STRATEGY 2018-19

Contents paragraph

GIS Investment Strategy 2018-19

Limits and Compliance

1.0 **All limits, unless explicitly stated otherwise, refer to the composition of the daily balance of the GIS**; for compliance purposes, all limits will be assessed daily.

2.0 The making of any investment which causes a breach of limits is not permitted and constitutes an **active exception.**

3.0 **Active exceptions of any size will be reported immediately** upon identification to the CIO, Syndics and their nominated substitutes. Relevant committees or boards will be notified as specified in each Participant's TMSS.

4.0 Additionally, breaches of daily limits may occur due to changes in the GIS balance or the credit assessment of existing investments, including the credit status of the country of domicile. Such an occurrence constitutes a **passive exception**. Passive exceptions will be reported immediately to the CIO, the GLA's statutory CFO and his deputy. Subsequent reporting will be threshold based as follows:

Passive Exception Level (lower of)	Temporary: ≤ 3 consecutive days	Persistent: >3 days
<5% or £25m	Logged and reported quarterly to Syndics within 1 month of quarter end	Logged and reported quarterly to Syndics within 1 month of quarter end
5-10% or £50m	Logged and reported quarterly to Syndics within 1 month of quarter end	Reported to Syndics immediately
>10% or £50m	Reported to Syndics immediately	Reported to Syndics immediately

The percentage limits above apply to total daily balance of the GIS or the total number of days in the case of limits expressed as days.

5.0 As an additional, prudent measure, forward looking diversification limits for new, internally-managed investments shall be maintained. These limits **apply to the forecast average GIS balance over the life of the investment being considered**; for operational expediency the forecasts shall be produced up to the last day of the following maturity 'buckets' given in days and limits applied accordingly:

O/N	2-7	8-30	31-60	61-90	91-120	12-150	151-180	181-210	211-240	241-270	271-300	301-330	331-397	398-730

6.0 If an investment is made in breach of these forward-looking limits, it is an active breach of investment strategy and will be reported per 3.0. Where changes in cash flow forecasts or counterparty and/or instrument status result in forward-looking limits being exceeded by existing investment positions, the CIO will be notified, who may then modify investment tactics to reduce the likelihood of a passive exception as defined in 4.0 occurring. Such an occurrence does not constitute an exception of any kind and need not be reported further.

7.0 Mitigating actions for all breaches will in the first instance be taken at the discretion of the CIO (or the GLA's statutory CFO, or his deputy). Such decisions must be supported by an analysis of the costs and benefits of attempting to reduce the overexposure in question versus tolerating it. In all cases a file note of the decision will be retained and circulated to the Syndics. A majority of the Syndics may instruct alternative action.

Risk Appetite Statement

8.0 Capital preservation is the primary GIS objective at the portfolio level, followed by provision of liquidity to meet Participants' cash flow needs.

9.0 In order to deliver best value on public funds, the Participants are prepared to take some investment risk to the extent outlined below, where such risk is rewarded by yields above UK government securities held to maturity.

10.0 The risk of loss through default in the entire portfolio (or any subsection delegated to an external manager) should not exceed risk of loss through default equivalent to a 1 year exposure to a typical AA-rated issuer.

11.0 No individual instrument/investment should pose a greater risk of loss through default than a 90 day exposure to a typical BBB issuer.

12.0 The Participants will tolerate price volatility where there is an expectation of holding an investment to maturity; where the expectation is that sale before maturity is likely or where the investment is in a variable NAV fund, the combined risk of loss through default and crystallised falls in price should not exceed the risk tolerance specified in 10.0.

13.0 This strategy sets out risk controls and limits that, in the opinion of the Participants, deliver these objectives.

14.0 Alternative controls and limits, save for the overarching requirements of 15.0-17.0 and 21.0, may be used by external managers appointed in accordance with **Error! Reference source not found.**, if those limits are judged by the Syndics, on the advice of the CIO or other independent professional advice, to be appropriately effective.

Permissible Investments

15.0 All investments must be Sterling-denominated financial instruments

16.0 Specified Investments (i.e. 'low risk' instruments as defined by Statutory Guidance) shall constitute at least 50% of the portfolio at any time.

17.0 Approved Specified (S) and non-Specified (NS) Investments:

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of daily balance
Senior Unsecured Debt • UK Gilts and T-Bills • Deposits • Call Accounts • Notice Accounts • Certificates of Deposit • Loans • Commercial Paper • All other senior unsecured bonds	Issuer (and security where separately rated) Investment Grade (IG) defined per 37.0 OR UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) OR Issuer not meeting general criteria but instruments explicitly guaranteed by IG entity or sovereign national government meeting acceptable sovereign ratings per 32.0	S	NS	100%
Constant Net Asset Value Money Market Funds	Fitch AAA_{mmf} or above See 37.0 for equivalents from other agencies. Daily liquidity	S	*N/A*	100% *Not more than 20% per fund*
Other Collective Investment Schemes structured as Open Ended Investment Companies (**OEICs**)	Fitch AAA_f or equivalent from other agencies per 37.0	NS	*Not permitted.*	20%

Investment type	Eligibility criteria	≤ 1 year to maturity at time of investment	> 1 year to maturity at time of investment	Maximum total exposure as a proportion of daily balance
Senior UK Prime or Buy to Let **Residential Mortgage Backed Securities** (RMBS)	Bond rating Fitch AA+$_{sf}$ or above or equivalent from other agencies per 37.0	NS	NS	20%
Covered bonds	Bond rating Fitch AA+$_{sf}$ or equivalent from other agencies per 37.0 AND Issuer rated Fitch A- or above or equivalent from other agencies per 37.0	NS	NS	20%
Repurchase Agreements (Repo)	Counterparty meets senior unsecured criteria AND proposed collateral (Min 100%) itself meets permitted investment criteria Or Collateralisation is >102% with UK Gilts / T-Bills	S – UK gilts or T-Bills AND Counterparty meets senior unsecured criteria NS – other	*Not permitted.*	S – 100% NS – 20%, and not more than 10% with counterparties not meeting senior unsecured criteria.

18.0 The Syndics may delegate the management of a portion, not exceeding the forecast minimum GIS balance for the next 12 months, of the GIS to external fund managers if this is deemed prudent.

Liquidity and Maturity Limits

19.0 Portfolio Weighted Average Maturity (WAM) ≤ 91days

[Maturity here refers to the final expected maturity or if relevant the first call option of the instrument; in the case of funds the maturity will be the redemption period; in the case of call or notice accounts, the notice period].

20.0 Sub-portfolio (managed by an external manager) WAM ≤ 3years

Individual maturity limit, internally managed instruments: ≤ 2 years

[In the exceptional event of the internal team taking possession of repo collateral, e.g. gilts that exceed this limit, the expectation is that these will be sold at the earliest opportunity, subject to market conditions]

21.0 Individual maturity limit, externally managed instruments: ≤ 5 years

[Note – in the case of RMBS these limits apply to the date by which all principal is expected to received, based on analysis of the underlying mortgage pool and indicated call dates – the legal maturity date, based on the longest dated mortgage in the relevant pool, is not limited given the extremely low probability of the bond failing to be repaid by that time;

In the case of covered bonds, these limits apply to the expected maturity date, which may not include the exercise of the extension option]

22.0 Limit for total exposure >12months: ≤25% of total daily balance.

23.0 Forward Dealing limit: aggregate value of outstanding forward deals ≤20% of daily balance; forward deals must not be struck with an individual counterparty if the limit forecasts defined in 5.0 indicate this is likely to cause an exception. See also 43.0 for credit risk management of forward deals.

[The GIS defines 'forward' as negotiated more than 4 banking days in advance of delivery. The CIO may make exceptions to this limit where the counterparty is a GIS Participant and the forward period is less than 3 months]

24.0 Internally managed investments should only be made where GIS cash flow forecasts or best estimates suggest the instrument may be held to maturity. Externally managed investments may be purchased with lower certainty subject to the provisions of 12.0

Counterparty Concentration Limits

(Apply individually and cumulatively to groups)

25.0 The total exposure to a group of companies (a parent company and any subsidiaries, i.e. companies of which it owns 20% or more of authorised share capital) shall not exceed the maximum individual exposure limit of the constituents of the group.

26.0 Maximum unsecured exposure to company or group: ≤5% (subject to enhancements below)

27.0 Enhanced limits apply for UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance) and institutions covered by Capita's Colour Banding Methodology:

Cash Exposure Limits – applied to individual counterparties		
Band	**Overnight**	**> 1 day**
UK Sovereign	100%	100%
Yellow	50%	25%
Purple	50%	20%
Orange	25%	15%
Red	25%	10%
Green	10%	5%
No Colour	5%	5%

28.0 The Bands above are calculated based on a range of credit ratings data, including published rating Watches and Outlooks. Where the price of 5 year Credit Default Swaps for a given counterparty exceeds barrier levels proposed by Capita with regard to market history, the Band will normally be adjusted downwards. The CIO may postpone such adjustments in consultation with the Syndics, for instance, if it is felt that changes in CDS prices do not reflect an increase in the individual credit risk of a particular counterparty.

29.0 Additionally, an enhanced overnight limit of 100% applies to the GIS banker, RBS.

30.0 If, in the judgement of the Chief Investment Officer, the structure of a bond associated with a local authority is such that the credit risk is not identical to a bilateral loan with that authority, the rating of the bond itself will be used and the 5% limit will apply.

31.0 Maximum aggregate exposure including indirect or collateralised exposures:

Security Type	Cumulative Enhancement
Non-specified Repo	2.5%
Covered Bond	5%
RMBS	7.5%
Specified Repo	10%

[These enhancements are cumulative so the maximum possible total enhancement is 10% above is the counterparty's senior unsecured limit]

Geo-political risk limits

32.0 The GIS will seek to reduce exposure to geo-political impact on credit risk by investing in companies that operate in stable economies. In particular, the GIS recognises a particular linkage between countries' national finances and their banking sectors, and considers sovereign credit ratings to be related to national financial stability.

33.0 Maximum exposures to non-UK financial institutions apply by country, based on the relevant sovereign ratings outlined in the table below:

Max. Aggregate Exposure (%)	Fitch Sovereign Rating	S&P Sovereign Rating	Moody's Sovereign Rating
25	AAA	AAA	Aaa
15	AA+	AA+	Aa1
5	<AA+	<AA+	<Aa1

34.0 Where more than one rating is available the lowest common denominator will be used, unless in the opinion of the CIO there is an overriding reason to favour or disregard a particular agency's view. The use of this discretion will be reported in the following weekly report to the Syndics.

35.0 For non-UK, non-financial institutions, or in circumstances such as an instrument being issued through a subsidiary domiciled in one country but guaranteed or otherwise secured by a parent in another, the risks and appropriate country limit (if any, in the case of multinational corporations) in which to aggregate the exposure will be considered on a case by case basis and determined by the CIO. A written copy of the assessment of each such counterparty and/or instrument will be filed with the investment and shared with the Syndics as part of weekly reporting. A majority of syndics may overrule such determinations.

36.0 Any member of the investment team may decline to place an investment and the CIO may indefinitely suspend any counterparty or group of counterparties on the basis of geo-political risk considerations, howsoever arising. Such use of discretion will be reviewed at weekly team meetings and where restrictions are imposed or subsequently withdrawn, this will be shared with the Syndics as part of weekly reporting.

Credit Risk Limits

37.0 Permitted issuer credit ratings and equivalence mappings

Senior Unsecured Bond and/or Issuer Ratings					
Long term			Short term		
Fitch	**Moody's**	**S&P**	**Fitch**	**Moody's**	**S&P**
AAA	Aaa	AAA			
AA+	Aa1	AA+			
AA	Aa2	AA	F1+	P-1	A-1+
AA-	Aa3	AA-			
A+	A1	A+			
A	A2	A	F1	P-1	A-1
A-	A3	A-			
BBB+	Baa1	BBB+			
BBB	Baa2	BBB	F2	P-2	A-2

Structured Finance Ratings		
Fitch	**Moody's**	**S&P**
AAA$_{sf}$	Aaa (sf)	AAA (sf)
AA+$_{sf}$	Aa1(sf)	AA+ (sf)

Money Market Fund Ratings		
Fitch	**Moody's**	**S&P**
AAA$_{mmf}$	Aaa-mf	AAAm

Other Permitted Fund Ratings		
Fitch	**Moody's**	**S&P**
AAA$_{f}$	Aaa-bf	AAAf

38.0 Where more than one rating is available the lowest common denominator will be used, unless in the opinion of the CIO there is an overriding reason to favour or disregard one particular agency's view. The use of this discretion will be reported immediately to the Syndics.

39.0 For internally managed investments Credit Factors will also be calculated individually and Portfolio Credit Factor (PCF) on a book value weighted average basis with reference to the following tables:

Credit Factors based on Issuer Default Rating (Fitch and Fitch Equivalents) Use instrument rating or if not rated, rating of Issuer.									
Days	AAA	AA+	AA	AA–	A+	A	A–	BBB+	BBB
O/N	0.01	0.01	0.01	0.01	0.02	0.03	0.04	0.07	0.10
2-7	0.02	0.04	0.06	0.10	0.15	0.20	0.30	0.50	0.80
8-30	0.10	0.15	0.25	0.40	0.60	0.75	1.30	2.10	3.50
31-60	0.20	0.30	0.50	0.80	1.20	1.50	2.60	4.20	7.00
61-90	0.25	0.50	0.75	1.25	1.50	2.50	5.00	7.50	10.00
91-120	0.35	0.65	1.00	1.50	2.30	3.30	6.60	10.00	13.50
121-150	0.40	0.80	1.25	2.10	2.90	4.20	8.30	12.50	16.50
151-180	0.50	1.00	1.50	2.50	3.50	5.00	10.00	15.00	20.00
181-210	0.60	1.20	1.75	3.00	4.00	5.80	11.70	17.50	23.50
211-240	0.70	1.30	2.00	3.30	4.70	6.60	13.30	20.00	27.00
241-270	0.75	1.50	2.25	3.75	5.25	7.50	15.00	22.50	30.00
271-300	0.80	1.70	2.50	4.20	5.80	8.30	16.70	25.00	33.50
301-330	0.90	1.85	2.75	4.60	6.50	9.20	18.50	27.50	37.00
331-397	1.00	2.00	3.00	5.00	7.00	10.00	20.00	30.00	40.00
398-730	2.70	5.30	8.00	13.00	19.00	27.00	43.00	69.00	106.00

Other treatments	
UK Government (including the Debt Management Account Deposit Facility, Local Authorities and bodies eligible for PWLB finance)	Treat as AAA above Except: If, in the judgement of the Chief Investment Officer, the structure of a bond associated with a local authority is such that the credit risk is not identical to a bilateral loan with that authority, the rating of the bond itself will be used
Instruments explicitly guaranteed by IG entity or sovereign national government meeting acceptable sovereign ratings per 32.0	Use Credit Factors appropriate to guarantor strictly for the period of the guarantee, reverting to rating of issuer thereafter
Repo	Use Credit Factors appropriate to repo counterparty, not collateral; Unrated or sub-BBB counterparty with >102% Gilt/T-bill collateralisation – treat as BBB
Approved fund, e.g. AAA_f or AAA_{mmf}	Use Credit Factor of 1.5
Covered Bonds or RMBS	Use Credit Factor of 5

40.0 Where a counterparty's (or its country of domicile's) 5 year CDS spreads exceed barrier levels from time to time agreed by the Syndics on the advice of Capita or the CIO, the Credit Factor used for the PCF calculation will be from the factor set of one or more notches below the issuer or security rating (e.g. If a AA+ counterparty's CDS spread exceeds the first barrier level, AA factors will be used to calculate the PCF).

41.0 The following limits apply at all times:

- Maximum Credit Factor of any single security: 10.00
- Maximum PCF: 5.00

42.0 The PCF will be calculated and recorded daily.

43.0 The total contractual exposure of any transaction with counterparty, i.e. in the case of a forward deal, the forward period PLUS the eventual length of the deal should be considered at the time of the transaction and compared to table 39.0 – the Credit Factor for the total exposure period at the counterparty's credit rating at the time of the deal must not exceed 10.

Deposit Facility of Last Resort

44.0 In the circumstance of being unable to place funds with counterparties within approved limits, the Investment Manager will attempt to place the surplus funds with the Debt Management Account Deposit Facility (DMADF). This facility may, of course, also be used in other circumstances if it offers rates above equivalent market levels, though in past experience this is unlikely.

45.0 In the instance of technical failures or unexpected monies being received after the cut-off time for sending payments, the GLA, as the GIS Investment Manager, will have no choice but to leave the funds with the GLA's bankers, RBS. In such circumstances, the funds will be moved to the GLA's call account at RBS.

Custody Arrangements

46.0 Internally or externally managed securities may be held by a Custodian; in such circumstances:

a. The Custodian or any Sub-Custodian employed by the Custodian (whichever actually holds the GIS securities) must be Fitch A- rated or equivalent
b. Any cash held by the Custodian or any Sub-Custodian pending transactions must be properly identified as an unsecured deposit and consolidated into the PCF calculation
c. The Custodian or any Sub-Custodian shall not be entitled to invest such cash in any money market fund or other product without the permission of the GIS. Any such investment must meet the criteria of 17.0.

47.0 The above applies to any Custodian or Sub Custodian holding collateral on behalf of the GIS in respect of a Repo transaction. Note – 'Held in Custody' Repos where collateral is held at the borrower's custodian in the borrower's title are NOT permitted.

CIO Discretions

48.0 The CIO may restrict the use of any counterparty for any reason related to the management of risk, including reputational risk to any Participant. Such restrictions may be overturned by any majority of Syndics.

49.0 When postponing CDS-driven adjustments to exposure limits, the Group Treasury team will notify the Syndics of the CIO's decision immediately. Syndics will have until 12pm to register concerns otherwise the decision will be implemented for that day. Any majority of Syndics may reverse the decision subsequently.

50.0 All above mentioned CIO discretions may also be exercised by the GLA's statutory CFO and his deputy.

Responsible Investment

51.0 All investment will be made in accordance with the following policy with respect to fossil fuel companies:

GLA Group Responsible Investment Statement on Climate Change

The Greater London Authority is committed to a number of principles which guide their investment decisions. The Greater London Authority will consider non-financial factors when investing, such as alignment of the activities of investment counterparties with Mayoral policy on environmental and social impact, providing no compromise of fiduciary duty arises from such considerations.

Regarding climate change in particular, the Authority will not actively invest in companies or projects ("fossil fuel companies" and "fossil fuel projects") that derive more than 10% of revenues from the extraction of fossil fuels, ignore the impact and risks associated with the use of fossil fuels, and are unable to demonstrate a commitment to achieving environmental benefits, in particular through a plan to limit climate change in line with the Paris Agreement:

http://unfccc.int/paris_agreement/items/9485.php

The Authority notes a distinction between Natural Gas, which will continue to play a valuable role out to 2030, both for heating and for electricity generation, and other fossil fuels; nevertheless the Authority would expect a demonstrable commitment to achieving environmental benefits from companies involved in gas extraction.

In order to assess the level of commitment to achieving environmental benefits, the Authority will make use of the Transition Pathway Initiative, as adopted by a range of leading institutional investors:

http://www.lse.ac.uk/GranthamInstitute/tpi/about/

Where such investments are already in place, and opportunities for engagement and reform of the company or project do not exist, the Authority will make all reasonable efforts to divest provided that this will result in no material financial detriment (either through cost or increased investment risk).

The Authority views divestment and avoidance of any long term financial exposure to such companies or projects as entirely consistent with its fiduciary duty to protect and obtain best value from public funds. This is also consistent with the Mayor of London's climate change goals and commitment to ensuring that optimum low carbon investment decisions are taken, to help to maximise social and economic benefits. .

To explain these statements concisely the Authority makes the following definitions, with examples of application:

"invest" – in this context, investment means the acquiring ownership of all or part of a fossil fuel company or otherwise providing financial support to such a company or any project which ignores the environmental impact and risks associated with Fossil Fuels;

"actively" – means making a choice to invest based on a direct assessment of that company or project or to knowingly create a long term economic interest in such companies or projects.

"environmental benefits" – means reducing net carbon emissions over time.

"opportunities for engagement" – means the ability to meaningfully influence the strategy or development of the company or project. This might be through the exercise of voting rights, either individually or alongside like-minded investors or other routes;

"ignoring the impact and risks associated with fossil fuels" – means continuing or developing new business activities contributing to climate change through fossil fuel emissions or environmental damage resulting from relevant fuel extraction without regard to development of new and sustainable alternatives or other transition planning towards a lower environmental impact.

"long term financial exposure" – means exposure for more than 12 months, either through actual investment or commitments to invest (contingent or otherwise) where the length of the commitment plus the expected duration of the investment exceeds this period.

Examples of application:

- Making a loan to a fossil fuel company in order fund expansion of conventional extraction activities would meet the definition of investment for these purposes; making a loan to a fossil fuel company to develop an alternative technology would not.
- Purchasing a fossil fuel company bond, from another bond holder would not meet the definition as it does not lead to ownership or engagement, nor provide new financial assistance to the company. Participating in the purchase of newly issued long term bonds may or may not classify as investment depending on the proposed use of proceeds.
- Commercial Paper or other debt instruments with less than a year to maturity would not constitute investment in this context as there is no associated ownership or engagement, nor do the longer term risks associated with exposure to unsustainable industries (which this strategy seeks to mitigate) apply over the life of such instruments.
- Directly purchasing equity in a fossil fuel company would constitute an active investment.

- Buying units in an exchange-traded tracker fund, where the index is known to contain fossil fuel companies may or may not constitute an active investment. It would be active if the intent was for the allocation to be a permanent part of the investment portfolio *and* the composition of the index was weighted more than 10% towards fossil fuel companies; it would not if the purchase was made to maintain broad market exposure, for instance during a transition between active portfolios. In any circumstance, the Authority seeks to influence the composition of the market (reflected in passive investments) through its own active decisions and those of likeminded partners.
- Circumstances involving conglomerates with a mixture of subsidiaries, some of which may meet the fossil fuels company definition (whereas others may, for example, be focused on renewable energy), would be considered on a case-by-case basis, with investment being possible if the overall corporate strategy appears to be environmentally sustainable and offset the financial risks this statement seeks to mitigate.

Explanatory Notes

Background to the GIS Investment Strategy

i. The GIS is a vehicle for investing pooled short term cash balances belonging to 'participants', currently 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 (GLA). The GLA acts as the Investment Manager under the supervision of the Syndics (the participants' respective chief financial officers).
ii. By pooling resources, the participants can achieve economies of scale through larger individual transactions; can exploit the greater stability of pooled cash flows to obtain better returns and can achieve greater levels of diversification.
iii. A risk sharing agreement ensures risk and reward relating to each investment within the jointly controlled portfolio are shared in direct proportion to each participant's daily investment.
iv. The Investment manager (the GLA) operates the GIS cash balances in accordance with the GIS Investment Strategy

Reporting thresholds – see paragraph 4.0 in the GIS Strategy

i. Reporting thresholds are capped at £25m and £50m, these limits are conservative based on the expected scale of the GIS – based on the GIS composition as at 1 January 2018, the absolute exposure reporting thresholds for each participant would be:

£m	25	50
GLA	20.4	40.8
LFEPA	0.2	0.5
MOPAC	0.2	0.3
LPFA	2.8	5.7
LLDC	0.2	0.4

Investment types – see paragraph 17.0 in the GIS Strategy

i. The concept of "Specified" and "Non-Specified" Investments is defined in the DCLG Guidance on Local Government Investments (revised 2010).

<u>Specified Investments</u>

ii. An investment is a Specified investment if all of the following apply:

a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
b) The investment is not a long-term investment (i.e. due or required to be repaid within 12 months);
c) The making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 3146 as amended) (i.e. the investment is not share capital in a body corporate)
d) The investment is made with a body or in an investment scheme of high credit quality (defined by the minimum credit ratings outlined in table 17.0) or with one of the following public-sector bodies:

- The United Kingdom Government

- A local authority in England or Wales (as defined in section 23 of the 2003 Local Government Act) or a similar body in Scotland or Northern Ireland

- A parish council or community

Non Specified Investments

iii. Non-Specified Investments are defined as investments assessed by the GIS Participants to be appropriate and prudent, but not meeting the one or more of the Specified Investments criteria.

iv. Reflecting increased market risk and difficulties in diversifying, this strategy includes the highly secure option of UK Residential Mortgage Backed Securities, which provides a genuine diversification away from institutional credit risk and additional options for secured lending, enabling limits to be increased with existing counterparties in exchange for security of some sort of asset in the event of the borrower becoming insolvent.

v. RMBS

- Since the approval of the GIS Participants' Treasury Strategies, which all set out the rationale for senior UK Prime and Buy to Let RMBS, the GLA has appointed two managers to manage £100m each of GLA core cash in this asset class.

  Almost half of the investments were made prior to the market turbulence following the EU referendum, enabling the GLA to reduce its exposure to banks; additionally, this action has provided an excellent market test of extreme conditions for the asset class. Unlike a number of banks and the UK itself, the ratings of UK RMBS were untouched by the negative market perception of the UK's actions and liquidity in the asset class was no worse than any other within the current investment strategy. Yield remains higher than other available options.

- 15 UK Banks and Building Societies have over £100bn of AAA-rated RMBS outstanding, via bankruptcy-remote issuing companies, which ensures full credit de-linkage

- This report therefore recommends inclusion of UK RMBS in the GIS subject to the limits proposed and the overall GIS WAM limit, in order to reduce risk and improve returns. The 20% limit reflects the fact that the GIS currently has a 91 day WAM limit and most of these instruments will have a WAM > 1 year.

- Only senior RMBS are permitted at this stage, i.e. the GIS has first priority over the cash flows from the underlying pools of thousands of diversified UK residential prime or buy-to-let mortgages. These to date have always been AAA rated at inception with some isolated cases of downgrades to AA+ due to lower ratings of associated counterparties within the RMBS structure such as the bank servicing the mortgages, rather than the underlying mortgages, reflecting the increased risk of possible payment disruption should the servicing bank fail (though no increased risk of non-payment). The strategy does not exclude these downgraded senior notes as the risk of loss is still very low but it should be noted that changes to RMBS structures since 2008 make this circumstance very unlikely in future.

- The cash flows from RMBS are generated by both interest and principal repayments of the mortgages in the relevant pool. In particular, when homeowners refinance (or move house) the pool experiences principal inflows, which are then passed through to the RMBS bondholders (which the most senior tranches, proposed here, receive before all others). Refinancing typically occurs much earlier than the final date of the mortgage, therefore it is not proposed to limit the legal maturity of RMBS, as these are set with reference to the longest dated mortgage in the pool and do not reflect the expected maturity date. In addition, RMBS deals are structured with financial penalties for the issuer beyond the expected maturity date, to ensure that deals mature as expected.

- The strong cash flow characteristics of senior RMBS mean that principal is repaid incrementally, therefore a proposed WAM limit of 3 years per security for the whole RMBS portfolio is proposed alongside a 5 year expected final maturity limit per security.

vi. Covered Bonds

- Covered bonds are also secured on mortgage assets, but do not depend on mortgages for the cash flows. They are more like a normal bond issued by the relevant bank or building society except that should the issuer default, the covered bond holders will have security over the banks' mortgage assets, which could be sold to another bank to meet the obligation.

- Whilst the credit risk is clearly lower than unsecured lending to the issuer, the situation is different to RMBS and when the issuer is downgraded, covered bonds are typically downgraded too. Accordingly, the strategy does not permit the use of covered bonds issued by counterparties who do not themselves meet approved investment criteria.

- Another feature of covered bonds are extension clauses, typically of 2 years. For this reason, the strategy only permits the use of counterparties of A- rating or above to allow for downgrades over the extension period, should it be invoked.

- Because they are lower risk than unsecured lending to a given counterparty, covered bond yields are generally lower. Accordingly, the main circumstance in which they would be used in the current environment is to increase exposure to a strong and well understood counterparty already at its unsecured concentration limit.

vii. Repurchase Agreements "Repos"

- Repos are a form of secured lending whereby rather than lend directly to a counterparty, the GIS would buy from them a security e.g. a bond and agree to sell it back at an agreed (higher) price at a future date. The profit on this transaction replaces interest in a normal lending agreement but there is the additional feature that if the borrower becomes insolvent, the GIS may keep the security, which is referred to as collateral.

- For this reason, only securities that meet GIS criteria may be accepted as collateral, however the duration limits of 21.0 and 20.0 do not apply since the expectation is that the collateral will be disposed of at the first opportunity and over-collateralisation provides mitigation for any price movement.

- Furthermore, if such a default occurred, the GIS may need to sell the collateral for cash flow reasons so there may be some price risk between the default and the sale. Therefore, minimum levels of collateral, expressed as a percentage of the market value of collateral relative to the purchase price, are proposed.

- The strategy permits very limited repo exposure (2.5% and 10% in aggregate) to counterparties not meeting unsecured investment criteria. In this case, minimum collateral is set at 102% (in line with minimum standards for repo use by AAA rated money market funds) and the provision is designed to enable transactions with pension funds engaged in liability hedging activities, to mutual advantage.

- There are a number of ways to implement a repo. This is delegated to officers and their advisors or external managers, however per 47.0, legal title to the collateral must be unequivocally obtained and safe custody arrangements be in place.

- Repos will provide a further tool for balancing GIS risk and return: the risk is very much lower than unsecured lending to banks and others, although not as low as T-bills, however repo returns are slightly higher than T-Bills and there is more flexibility with maturity dates.

Weighted Average Maturity see paragraph 20.0 in the GIS Strategy

i. For the purposes of this limit, WAM is the sum of each expected nominal cashflow and its respective expected incidence in days from the calculation date, divided by the total nominal cashflows; the use of expectations rather than contractual maturities reflects the use of instruments like RMBS which are subject to uncertain repayments. The Syndics place reliance on the systems and investment process of appointed managers to monitor and implement this limit.

Credit Default Swaps (CDS) - see paragraph 28.0 in the GIS Strategy

i. Credit Default Swaps (CDS) are effectively insurance contracts against a given counterparty defaulting; their price (typically expressed as an additional interest cost or 'spread' in basis points – i.e. 100ths of one percent). Higher prices may therefore reflect greater market perception of risk, although other supply and demand factors can distort this, including the activity of speculators. For this reason, the CIO has discretion to propose postponements to the impact of CDS data on limits.

ii. Although the GIS typically participates in short term investments, it refers to 5 year CDS prices as this market has higher volumes of trading and therefore more accurately reflects market sentiment.

iii. The GIS's advisor and data provider, Capita, proposes barrier levels dependent on market conditions as indicated by one of the main CDS indices, ITRAXX 5 year senior financials.

iv. When the ITRAXX is below 100 basis points, a counterparty's limit band will be adjusted down one notch if their CDS price is between 100 and 150 or to 'no colour' if above 150

v. When the ITRAXX is above 100, a counterparty's limit band will be adjusted down one notch if their CDS price between 1 and 50 basis points above the ITRAXX or to 'no colour' if more than 50 basis points above.

Book Value Weighted Average – see paragraph 39.0 in the GIS Strategy

i. Book value weighted average here means the sum of the products of principal sums invested (plus any capitalised interest, less any impairments or partial repayments but excluding any accrued interest or unrealised gains or losses) and the respective Credit Factors at the date of calculation, divided by the sum of principal sums invested (plus any capitalised interest, less any impairments or partial repayments but excluding any accrued interest or unrealised gains or losses)

CIO discretions – see paragraph 50.0 in the GIS Strategy

In the absence of the CIO, the senior member of the Group Treasury team present should assume responsibility for reviewing circumstances where discretion might be used, and make appropriate recommendations to the CFO or deputy, who will decide whether to exercise their powers under this strategy.

Appendix 5: Treasury Management Practices: Main Principles

1. INTRODUCTION

1.1 The Treasury Management Practices (TMPs): Main Principles below set out the manner in which the Authority will seek to achieve its Treasury policies and objectives. These TMPs: Main Principles follow the wording recommended by the latest edition of the CIPFA Treasury Management Code.

1.2 TMPs: Main Principles are supported by TMPs: Schedules, which provide specific details of the systems and routines employed and the records to be maintained to deliver the TMPs: Main Principles. These Schedules are maintained and updated as necessary, being operational procedures and forming an integral part of the Authority's treasury management manual.

1.3 Approval and monitoring of TMPs is a matter for local decision. As such the TMPs: Principles will be approved by the Authority and monitored by the Director of Finance and Contractual Services and annually reviewed by the Authority before the start of the year.

1.4 TMPs: Schedules will be approved, monitored and annually reviewed by the Director of Finance and Contractual Services.

1.5 Scrutiny of the approval and monitoring of TMPs will be performed by the Resources Committee following recommendations by the Director of Finance and Contractual Services.

2. TMP1 RISK MANAGEMENT

2.1 <u>General statement</u>

2.1.1 The Director of Finance and Contractual Services will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Authority's objectives in this respect, all in accordance with the procedures set out in TMP6 'Reporting requirements and management information arrangements'.

2.1.2 In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the TMPs: Schedules.

2.2 <u>Credit and counterparty risk management</u>

2.2.1 The Director of Finance and Contractual Services regards a key objective of the Authority's treasury management activities to be the security of the principal sums it invests. Accordingly, he/she will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit investment activities to the instruments, methods and techniques referred to in the TMP4 Approved instruments, methods and techniques and listed in the TMPs: Schedules. The Director of Finance and Contractual Services also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which the Authority may borrow, or with whom it may enter into other financing arrangements.

2.3 Liquidity risk management

2.3.1 The Director of Finance and Contractual Services will ensure the Authority has adequate though not excessive cash resources, borrowing arrangements, or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business,/service objectives.

2.3.2 The Director of Finance and Contractual Services will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

2.4 Interest rate risk management

2.4.1 The Director of Finance and Contractual Services will manage Authority exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 'Reporting requirements and management information arrangements'.

2.4.2 The Director of Finance and Contractual Services will achieve this by the prudent use of Authority approved instruments, methods, and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

2.5 Exchange rate risk management

2.5.1 The Director of Finance and Contractual Services will manage its exposure to fluctuations in exchange rates, so as to minimise any detrimental impact on its budgeted income/expenditure levels.

2.6 Refinancing risk management

2.6.1 The Director of Finance and Contractual Services will ensure that Authority borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the Authority as can reasonably be achieved in the light of market conditions prevailing at the time.

2.6.2 The Director of Finance and Contractual Services will actively manage Authority relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

2.7 Legal and regulatory risk management

2.7.1 The Director of Finance and Contractual Services will ensure that all Authority treasury management activities comply with statutory powers and regulatory requirements. He/She will demonstrate such compliance, if required to do so, to all parties with whom the Authority deals in such activities. In framing its credit and counterparty policy under TMP[1] 'credit and counterparty risk management', he/she will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Authority, particularly with regard to duty of care and fees charged.

2.7.2 The Director of Finance and Contractual Services recognises that future legislative or regulatory changes may impact on treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Authority.

2.8 Fraud, error and corruption, and contingency management

2.8.1 The Director of Finance and Contractual Services will ensure that he/she has identified the circumstances which may expose the Authority to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, he/she will maintain effective contingency management arrangements, to these ends.

2.9 Market risk management

2.9.1 The Director of Finance and Contractual Services will seek to ensure that the Authority's stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect the Authority from the effects of such fluctuations.

3. TMP2 PERFORMANCE MEASUREMENT

3.1 The Director of Finance and Contractual Services is committed to the pursuit of value for money in the Authority's treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in the Authority's treasury management policy statement.

3.2 Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the TMPs: Schedules.

4. TMP3 DECISION-MAKING AND ANALYSIS

4.1 The Director of Finance and Contractual Services will maintain full records of Authority treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching these decisions are detailed in the TMPs: Schedules.

5. TMP4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

5.1 The Director of Finance and Contractual Services will undertake Authority treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 'Risk management'.

6. TMP5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

6.1 The Director of Finance and Contractual Services considers it essential, for the purposes of the effective control and monitoring of the Authority's treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

6.2 The principal on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

6.3 If and when the Authority intends, as a result of lack of resources or other circumstances, to depart from these principles, the Director of Finance and Contractual Services will ensure that the reasons are properly reported in accordance with TMP6 'Reporting requirements and management information arrangements', and the implications properly considered and evaluated.

6.4 The Director of Finance and Contractual Services will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The Director of Finance and Contractual Services will also ensure that at all times those engaged in treasury management will follow the policies and procedures. The present arrangements are detailed in the TMPs: Schedules.

6.5 The Director of Finance and Contractual Services will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the TMPs: Schedules

6.6 The delegations to the Director of Finance and Contractual Services in respect of treasury management are set out in the TMPs: Schedules. The Director of Finance and Contractual Services will fulfil all such responsibilities in accordance with the Authority's policy statement and TMPs and if a CIPFA member, the 'Standard of Professional Practice on Treasury Management'.

7. TMP6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS.

7.1 The Director of Finance and Contractual Services will ensure that regular reports are prepared and considered on the implementation of Authority treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

7.2 As a minimum:

The Authority will receive

- an annual report on the proposed strategy and plan to be pursued in the coming year
- a mid-year review
- an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's treasury management policy statement and TMPs.

7.3 The Resources Committee, as the body with responsibility for the scrutiny of treasury management policies and practices, will receive regular monitoring reports on treasury management activities and risks.

7.4 The Resources Committee responsible for scrutiny, such as an audit or scrutiny committee, will have responsibility for the scrutiny of treasury management policies and practices.

7.5 Local authorities should report the treasury management indicators as detailed in their sector-specific guidance notes.

7.6 The present arrangements and the form of these reports are detailed in the TMPs: Schedules.

8. TMP7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

8.1 The Director of Finance and Contractual Services will prepare, and the Authority will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 'Risk management', TMP2 'Performance measurement', and TMP4 'Approved instruments, methods and techniques'.

8.2 The Director of Finance and Contractual Services will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 'Reporting requirements and management information arrangements'.

8.3 The Director of Finance and Contractual Services will account for the Authority's treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory requirements in force for the time being.

9. TMP8 CASH AND CASH FLOW MANAGEMENT

9.1 Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this Authority will be under the control of the Director of Finance and Contractual Services, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Director of Finance and Contractual Services will ensure that these are adequate for the purposes of monitoring compliance with TMP1 (1.3) 'Liquidity risk management'. The present arrangements for preparing cash flow projections, and their form are set out in the TMPs: Schedules.

10. TMP9 MONEY LAUNDERING

10.1 The Director of Finance and Contractual Services is alert to the possibility that the Authority may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the TMPs: Schedules.

11. TMP10 TRAINING AND QUALIFICATIONS

11.1 The Director of Finance and Contractual Services recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. He/She will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Finance and Contractual Services will recommend and implement the necessary arrangements.

11.2 The Director of Finance and Contractual Services will ensure that Authority members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

11.3 Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

11.4 The present arrangements are detailed in the TMPs: Schedules.

12. TMP11 USE OF EXTERNAL SERVICE PROVIDERS

12.1 The Authority recognises that responsibility for the treasury management decisions remains with the Authority at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid overreliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Director of Finance and Contractual Services, and details of the current arrangements are set out in the TMPs: Schedules.

13. TMP12 CORPORATE GOVERNANCE

13.1 The Authority is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principals and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

13.2 This Authority has adopted and implemented the key principles of the TM Code. This, together with the other arrangements detailed in the TMPs; Schedules, are considered vital to the achievement of proper corporate governance in treasury management, and the Director of Finance and Contractual Services will monitor and, if and when necessary, report upon the effectiveness of these arrangements.