MOPAC | MAYOR OF LONDON
OFFICE FOR POLICING AND CRIME

REQUEST FOR DMPC DECISION – DMPCD 2014 153

Title: Treasury Management (TM) In-Year Review 2014-15

Executive Summary:

This paper requests the DMPC note the activity of the Treasury Management function for the first 6 months of the 2014-15 financial year.

In summary, investment and borrowing activity has been based on the guidelines and objectives set by the DMPC in the Treasury Management strategy approved on 1 May 2014. Interest income for the first half year is £0.86m, and is ahead of the annual budget of £0.8m. Debt management costs for the period are £3.95m, and are expected to be £7.8m against the full year budget of £9m.

All indicator limits were adhered to during this period.

Recommendation:

DMPC is asked to note activity and performance to date on the Treasury Management function.

Deputy Mayor for Policing and Crime

I confirm I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with the Code of Conduct for elected Members of the Authority. Any such interests are recorded below.

The above request has my approval.

Signature | **Date** 19/12/2014

PART I - NON-CONFIDENTIAL FACTS AND ADVICE TO THE DMPC

Decision required – supporting report

1 Introduction and background

1.1 DMPC approved the 2014-15 Treasury Management Strategy in May 2014 [DMPCD 2014 031]. As this strategy required operating both the GLA Group Investment Syndicate (GIS) and other activities the full implementation was effective from 3 July. Prior to this date treasury management activities were carried out under the previous strategy and in line with the GLA GIS.

2 Issues for consideration

2.1 Investment

2.1.1 The average size of the investment portfolio April to September 2014 was £372m. As at 30 September the balance was £339m.

2.1.2 The average rate of return was 0.46%, generating income of £0.86m. The annual budget for interest receivable is £0.8m. The rate of return achieved of 0.46% compares with the LIBID 3 month benchmark of 0.43%.

2.2 Borrowing

2.2.1 There has been no long term borrowing or temporary loans in the first six months of 2014-15, and due to the anticipated cash flow position no further borrowing is expected in 2014/15. There has been repayment of £50m of temporary loans and repayment of Equal Instalment of Principal (EIP) loan instalments of £7.23m in the year to date. This has resulted in a total debt as at 30 September 2014 of £212.61m.

2.2.2 Borrowing costs for the first 6 months was £3.95m, and are forecast to be £7.8m against a budget of £9m.

2.3 Treasury Management Prudential Code Indicators

2.3.1 All activity has been within the Prudential Code indicators – see Appendix 1.

2.4 Treasury Management Strategy 2015/16

2.4.1 Discussions are underway with the GLA and our Treasury Management advisers, Capita, to review the existing strategy to ensure that it remains fit for purpose for 2015/16. DMPC will be asked to consider and approve a 2015/16 strategy in March 2015.

3 Financial Comments

3.1 This is a financial report and the details are set out in the body of the report.

4 Legal Comments

4.1 There are no direct legal implications arising from this report.

5 Equality Comments

5.1 There are no equality and diversity implications arising from this report.

6 Background/supporting papers

GLA Report Appendix 1

Public access to information Information in this form is subject to the Freedom of Information Act 2000 (FOIA) and other legislation. Part 1 of this form will be made available on the MOPAC website within 1 working day of approval. Any facts/advice/recommendations that should not be made automatically available on request should not be included in Part 1 but instead on the separate Part 2 form. Deferment is only applicable where release before that date would compromise the implementation of the decision being approved.
Is the publication of **this** form to be deferred? NO If yes, for what reason: Until what date (if known):
Is there a **part 2** form – NO If yes, for what reason:

ORIGINATING OFFICER DECLARATION:

	Tick to confirm statement (✓)
Head of Unit: Annabel Cowell has reviewed the request and is satisfied it is correct and consistent with the MOPAC's plans and priorities.	✓
Legal Advice: The Legal team have been consulted on this proposal.	✓
Financial Advice: The Chief Finance Officer has been consulted on this proposal.	✓
Equalities Advice: Equality and Diversity issues are covered in the body of this report.	✓

OFFICER APPROVAL

Chief Operating Officer I have been consulted about the proposal and confirm that financial, legal and equalities advice has been taken into account in the preparation of this report. I am satisfied that this is an appropriate request to be submitted to the Deputy Mayor for Policing and Crime. **Signature**   **Date** 19/12/2014.

Title: MOPAC Treasury Management Mid-Year Review 2014-15

Executive Summary

The DMPC is being asked to note the review of Treasury Management activity for the period 1 April to 30 September 2014.

Income from investment activities for the period was £0.86m against an annual budget of £0.8m at an average rate of return of 0.46%.

Debt management costs for the period were £3.95m against an annual budget of £9.02m at an average cost of 3.65%. Estimated outturn for debt management costs is £7.79m.

All investment and borrowing activity throughout the period has been undertaken within the guidelines and objectives set out in 2014-15 policy and strategy.

Recommendation

The DMPC is asked to note the review of Treasury Management for the period 1 April to 30 September 2014.

Introduction/Background

1. This report provides details of all investment and borrowing activities for the period from 1 April 2014 to 30 September 2014 and highlights relevant issues currently under consideration by officers. The report provides a summary of the closing investment and debt positions as at 30 September 2014.

2. The MOPAC Chief Finance Officer confirms on the basis of assurances from the GLA Treasury Management shared service that, throughout the period, all treasury activities have been conducted within the parameters of the Treasury Management and Annual Investment Strategies for the financial year 2014/15 alongside best practice suggested by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Central Government. The DMPC approved the 2014/15 Treasury Management Strategy on 1 May 2014 (DMPCD 2014-031). The strategy moved away from the shared strategy under which the GIS operates and which MOPAC had previously adopted since joining the GIS in July 2013. The 2014/15 strategy was implemented on 3 July 2014, allowing time for GLA treasury officers to arrange operational facilities to be put in place in order to operate the strategy. MOPAC therefore continued to operate under the GIS Shared Strategy for the period 1 April to 2 July 2014.

3. Under the treasury management shared service arrangement with the GLA, GLA treasury officers carry out MOPAC's day to day treasury management function, managing MOPAC's investments and borrowing activities. MPS officers provide the GLA with details of MOPAC's daily cash flow requirements and monies are only transferred between the organisations as and when required to match MOPAC need. This way, surplus funds over and above daily need are continuously held with the GLA to maximise investment return.

Investment Activities

4. MOPAC invests its cash balances in accordance with the provisions of the Annual Investment Strategy, emphasising the priorities of security and liquidity above yield.

5. Following the introduction of the treasury management shared service the annual investment strategy permits the investment of short term balances in the GLA GIS operating under a version of the GLA's short term investment strategy, jointly controlled by the GLA and MOPAC through their respective chief financial officers. The GIS does not invest in counterparties other than those included in both authorities approved lists. By pooling MOPAC's short term balances with those of the GLA, the Authority is able to obtain additional liquidity and yield.

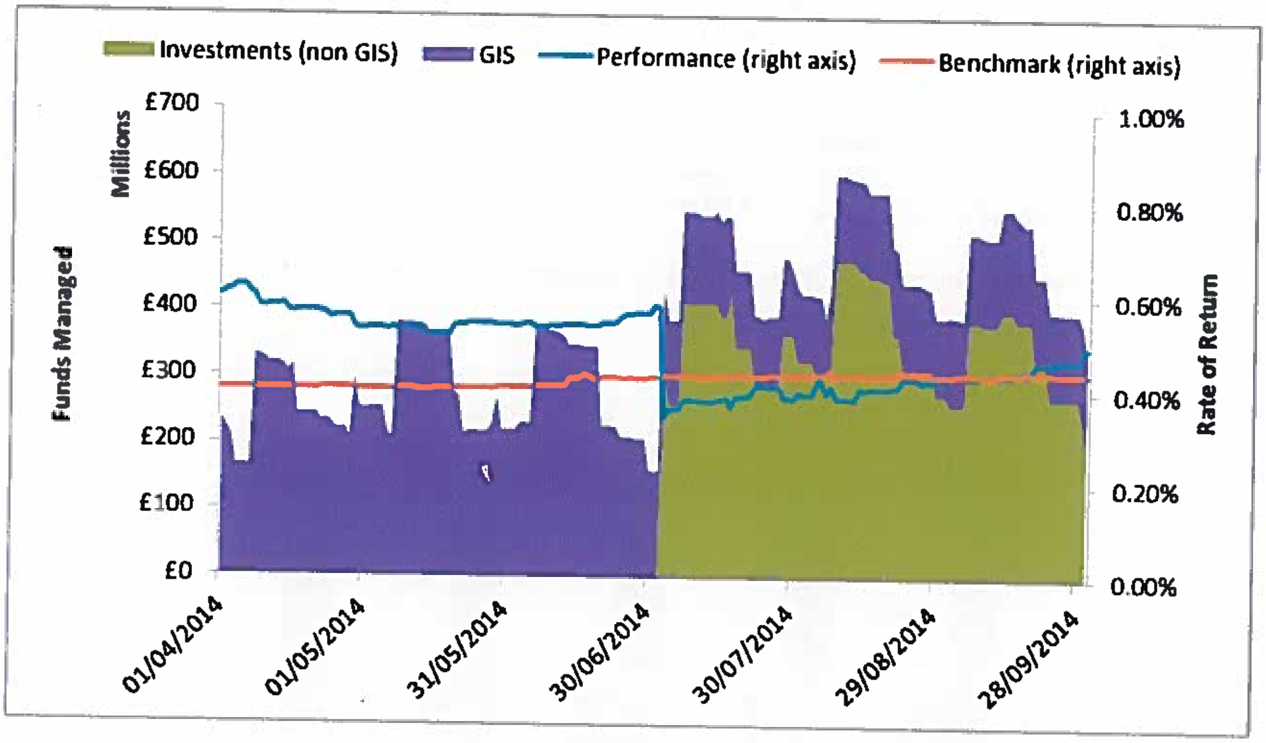
6. The GIS maintains a target weighted average maturity[1] (WAM) of not more than 3 months and additionally each participant may specify a portion of their investment to remain immediately accessible. The GIS therefore typically behaves like a combination of instant access call and 3 month notice accounts. However, throughout the majority of the period, the scale of the GIS fund's balances in relation to MOPAC's has been such that the GLA has been able to continue to offer MOPAC immediate access to its entire balance. This, together with the fact that the GIS has returned a rate in excess of most 6 month deposits in the market throughout the period led to all investments being held within the GIS up to 2 July 2014.

7. Implementation of MOPAC's 2014/15 Strategy on 3 July implemented fixed exposure limits with individual counterparties to minimise risk with anyone counterparty and therefore limited the balance which MOPAC could invest in the GIS. Treasury officers withdraw a significant portion of MOPAC's balance from the GIS and invested this in lower yielding instruments such as treasury bills. A total of 32 deposits were made during period 3 July to 30 September 2014 (excluding movement of funds into call accounts and GIS). These investments were made with six foreign banks, the Debt Management Agency Deposit Facility (DMADF) and through the purchase of Treasury Bills. The average size of investment was £42m and the average term 26 days. A call account with Svenska Handlesbanken was also used within the period, typically yielding higher than the fixed term deposits.

8. Figure 1 below shows the balance of all investment (left hand axis) over the period and MOPAC's average investment return performance (blue line) versus a benchmark of 3 month LIBID (orange line) measured on a percentage basis (right hand axis). The 3 month LIBID has remained steady over the period reflecting the availability of short term funds to the wholesale banking markets. The closing investment position as of 30 September 2014 was £339.05m with a WAM of 38.61 days and a forecast annualised yield of 0.44%. Cumulative performance for the period 1 April 2014 to 30 September 2014 was 0.46% versus a LIBID benchmark of 0.43% (gross outperformance of 0.03%). The average size of the investment portfolio during the first six months was £372m.

[1] The WAM is a measure of liquidity risk, stating how long, on average each pound within the portfolio is invested for.

Figure 1 – Investment balance and cumulative annualised performance to 30 September 2014



9. As at 30 September 2014, MOPAC had £195m in fixed term deposits and Treasury Bills with a weighted average interest rate of 0.41%, the GIS balance was £144 m, attracting an average return of 0.61%.

Table 1. Fixed term Investment maturities and outstanding balance as at 30 September 2014

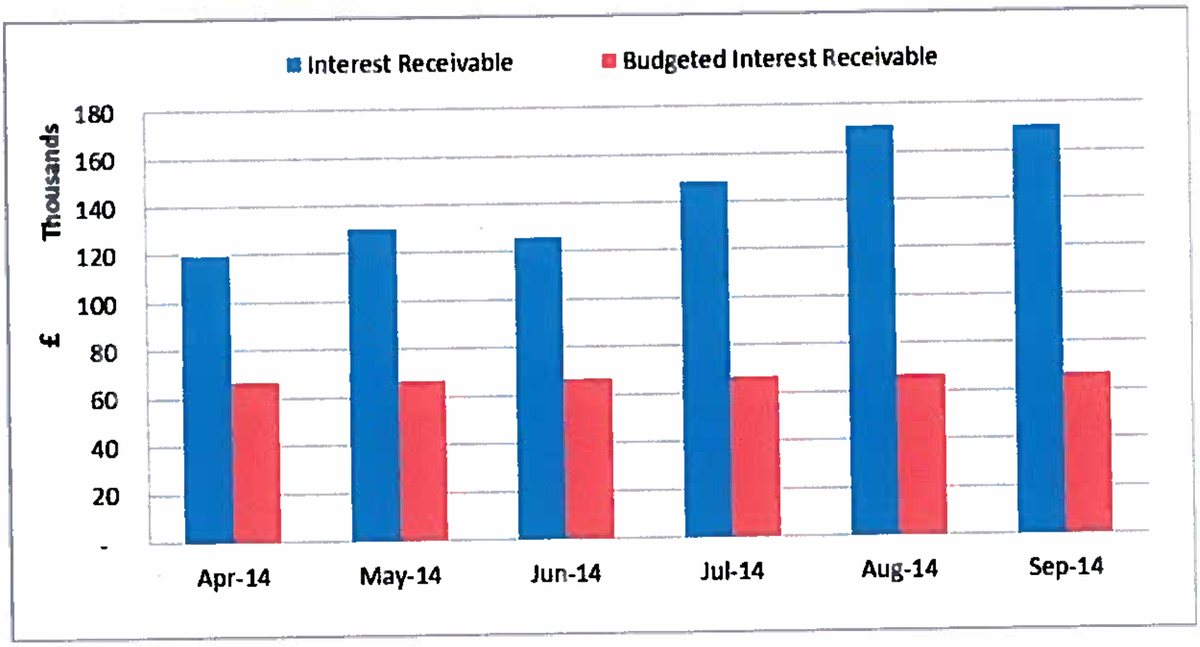
Counterparty	Principal (£)	Interest Rate	Maturity
DBS Bank Ltd	45,000,000.00	0.44%	6-Oct-14
Treasury Bills	24,992,906.12	0.37%	13-Oct-14
Bank of Nova Scotia	40,000,000.00	0.40%	20-Oct-14
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank)	40,000,000.00	0.42%	20-Oct-14
Bank of Montreal	45,000,000.00	0.42%	22-Oct-14

10. The GIS was able to deliver an average daily performance of 0.57% over the period while remaining within its liquidity target of a WAM not exceeding 3 months. The strong performance relative to equivalent LIBID rates is largely attributable to direct relationships with counterparties enabling the best rates to be secured. However, there have been recent, material reductions in the rates available, reflecting general market conditions.

11. To date the GIS has invested a large proportion of funds with Lloyds Bank, who consistently provided the best available rates within acceptable risk and liquidity parameters. Typically the GIS investment strategy enforces greater diversification, however while Lloyds remain in significant government ownership, they are treated as quasi-public sector risk, allowing large exposure. It should be noted that at a point when the Government chooses to divest material holdings, greater diversification will be required, potentially leading to a reduction in yield. In the opinion of officers and their advisors, this is unlikely to be fully implemented within a 6 month horizon, nevertheless investments with Lloyds are currently restricted in duration to ensure diversification can be quickly achieved when is necessary. The holdings of the UK Government in Lloyds now represent 24.9%.

12. Income from investment activities for the period was £0.86m. Figure 2 shows an outperformance in each of the first six months for interest receivable against budget, this is largely due to a higher than expected average cash balance over the period. Consequently, the forecast annual interest receivable is £1.6m against a budget of £0.8m, a variance of £0.8m.

Figure 2 – Interest receivable on investments vs budget to 30 September 2014



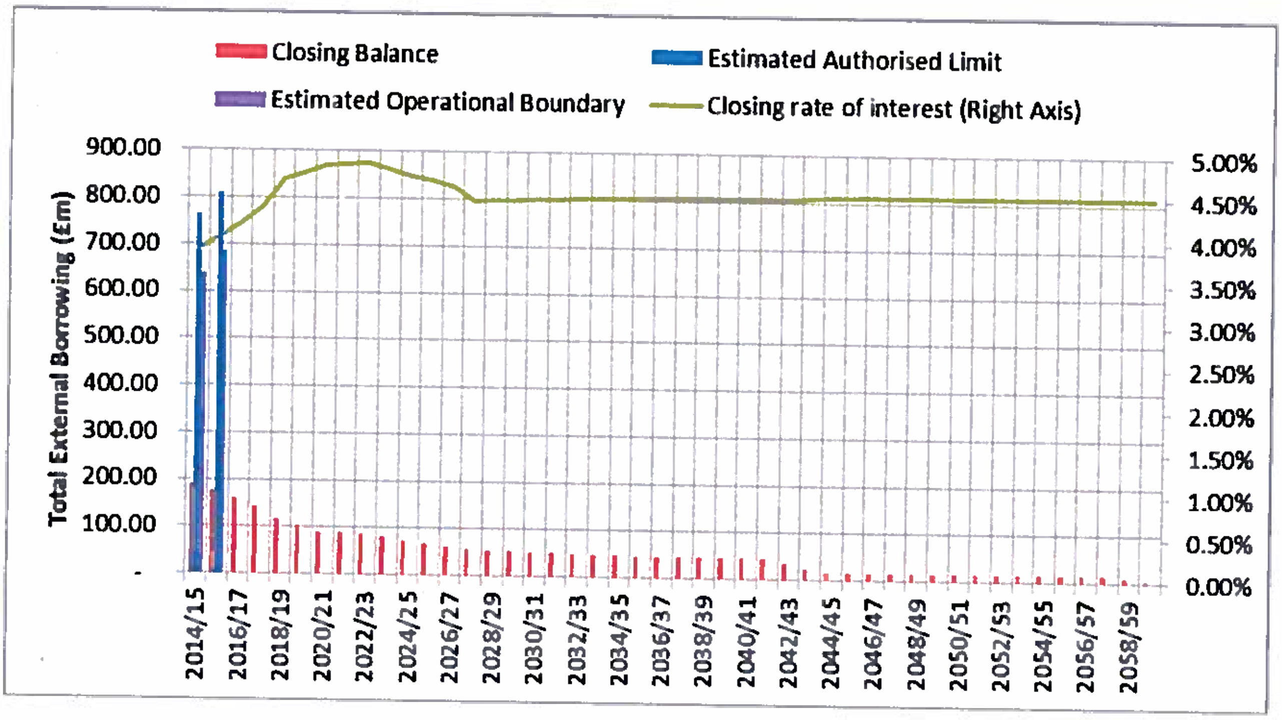
Borrowing and Debt Management

13. No new long term or temporary loans have been taken during the first six months of 2014/15. Taking into account the cash flow position it is not anticipated that any further borrowing will be required during 2014/15.

14. Temporary loans maturities totalling £50m were repaid in the first week of April 2014, given the cash flow position these were not required to be refinanced. Equal Instalment of Principal (EIP) loan instalments totalling £7.23m were also repaid in the year to date. As at 30 September 2014, the total borrowing portfolio stood at £212.61m with an average interest rate of 3.65% and a WAM of 13.65 years. Long term loans totalling £15m plus further EIP instalments of £7.23m are scheduled for repayment before 31 March 2015. All loans are fixed rate.

15. The maturity profile of the portfolio is illustrated below along with the key affordability indicators, the estimated Operational Boundary and Authorised Limit for 2014/15 through to 2015/16. Figure 3 also shows how the average rate will evolve as individual loans mature.

Figure 3 – Maturity profile of existing borrowing showing weighted average rate of interest



16. The Operational Boundary is set with reference to MOPAC's Capital Financing Requirement (CFR). The fact that, at year end, this is forecast to be some £426.6m higher than the current portfolio as at 30 September 2014 indicates MOPAC is internally borrowing, i.e. utilising reserves and other cash balances in lieu of external borrowing.

17. Current low investment rates mean that in the short term, internal borrowing is financially efficient (and also reduces investment risks), but the practice carries the risk that should MOPAC need to call on its reserves, it may be forced to borrow at a time when rates are unfavourable. Increases in interest costs at a time of reduced reserves could result in significant budgetary pressures. The potential future capital receipts could be used to help counter this risk.

18. Officers continue to assess the long term benefits and budgetary certainty of acquiring borrowing at the current very favourable rates versus the short term net additional cost. Officers are reviewing the possibilities of rescheduling debt, but while the PWLB's current policy of setting repayment discount rates considerably below new loan rates remains in force, there are unlikely to be economic reasons for debt rescheduling.

Treasury Management Indicators

MOPAC adopts the following indicators from the CIPFA Code of Practice for Treasury Management in the Public Services:

Table 2. Capital Expenditure

Capital Expenditure £m	2014/15 Original Estimate	Actual Position At 30.09.2014

Total	**331,340**	**66,567**

Table 3. Gross Debt and Capital Financing Requirement

2014-15 Actual Gross Debt At 30.09.2014 £000	2013-14 CFR £000	2014/15 Estimated Movement £000	2015/16 Estimated Movement £000	2015/16 Estimated Movement £000	Total CFR Over 4 Years £000	Amount Gross Debt < Total CFR over 4 Years £000
307,500	705,739	-11,646	-51,578	-27,631	614,884	307,384

Total principal sums invested in excess of 1 year

19. A combination of general investment risks and the level of internal borrowing requiring a strong liquidity position mean MOPAC does not view the acquisition of investments maturing in excess of 1 year as prudent for the financial year 2014/15. The limit is therefore nil and this was adhered to over the first six months of the financial year.

Limits to Borrowing Activity

Table 4. Operational Boundary

Operational Boundary	2014/15 Original Estimate £000	Actual Position At 30.09.2014 £000
Borrowing	639,200	212,610
Other LT Liabilities	104,100	94,890
Total Debt	743,300	307,500

Table 5. Authorised limit for External Debt

Authorised Limit	2014/15 Original Estimate £000	Actual Position At 30.09.2014 £000
Borrowing	764,200	212,610
Other LT Liabilities	104,100	94,890
Total Debt	868,300	307,500

Maturity Structure of External Borrowing

20. These limits seek to ensure refinancing risk is maintained within appropriate levels and that principal repayments are broadly matched to the financial resources planned to be used for that purpose.

Table 6. Maturity Structure of Borrowing

Maturity Bucket	TM Limits		30/09/2014
	Lower	Upper	Actual
Under 12 months	0%	20%	14%
12 months and within 24 months	0%	25%	8%
24 months and within 5 years	0%	40%	29%
5 years and within 10 years	0%	50%	12%
10 years and above	0%	100%	37%

Interest Rate Exposure

21. These limits seek to ensure refinancing risk is maintained within appropriate levels and that principal repayments are broadly matched to the financial resources planned to be used for that purpose.

22. MOPAC currently sets upper limits on fixed and variable interest rate exposures primarily to ensure that the risks associated with variable rate borrowing (of which there is currently none) are appropriately controlled. As at 30 September 2014, the position was fixed exposure of 100% and variable of 0%, with the respective upper limits of 100% and 50%.

Economic Context

23. After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of

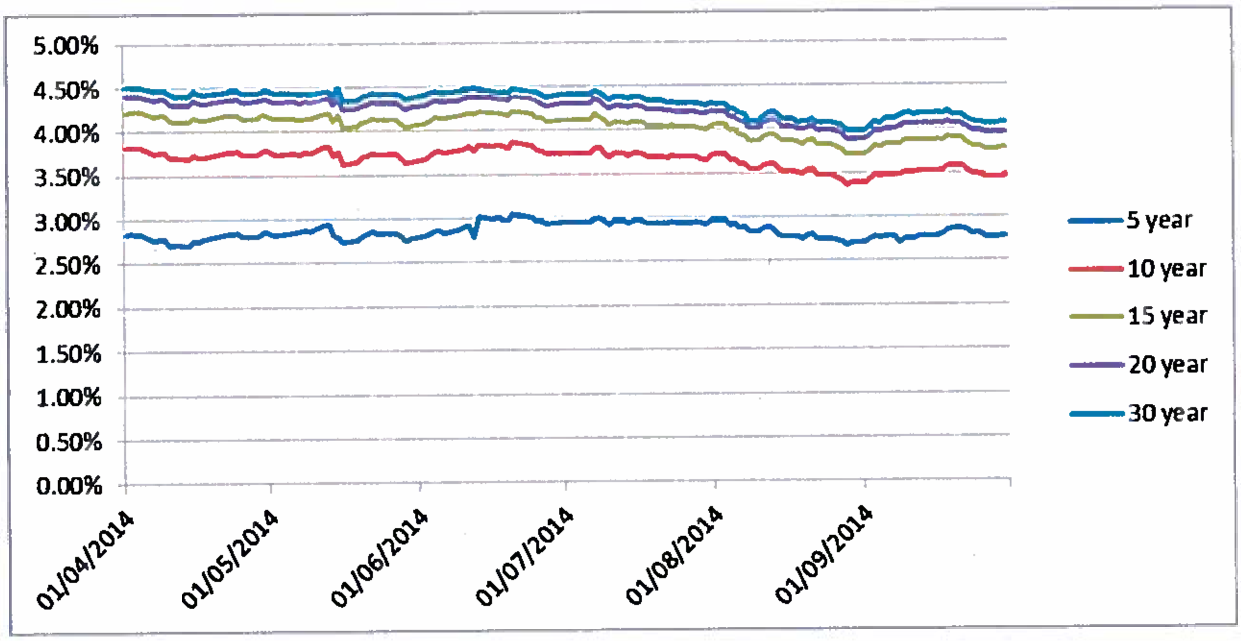
growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

24. Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%.

25. The Eurozone is facing an increasing threat from deflation. In September, the inflation rate fell further, to reach 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth.

26. Figure 4 below shows a slight decrease in Public Works Loan Board interest rates through the period. Longer term PWLB interest forecasts are shown in figure 6.

Figure 4 – Q3 PWLB rates (new loans with principal repayable on maturity)



27. Overall there remains a high level of uncertainty surrounding the economic environment. However, it is the view of officers and their advisors that despite asset purchase programmes, the overall high level of debt issuance by the UK and others will lead to an upward trend in long term borrowing costs. However, weakness in the economic outlook suggests there may be a longer wait before base rate increases. The following table shows the latest view of MOPAC's advisor, Capita, on bank rate and PWLB rates.

Figure 5 – PWLB Interest Rate Forecasts

	NOW	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50
3 month LIBID	0.50	0.50	0.60	0.80	0.90	1.10	1.30	1.40	1.60	1.90	2.10	2.10	2.30	2.40	2.60
6 month LIBID	0.65	0.70	0.80	1.00	1.10	1.20	1.40	1.50	1.80	2.00	2.20	2.30	2.50	2.70	2.80
12 month LIBID	0.93	0.90	1.00	1.20	1.30	1.40	1.70	1.80	2.10	2.20	2.30	2.40	2.60	2.80	3.00
5 yr PWLB	2.40	2.50	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.50	3.50	3.50
10 yr PWLB	3.00	3.20	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.10	4.20	4.20	4.30	4.30
25 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00
50 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00

Financial Comments

28. This is a financial report and the details are set out in the body of the report.

Legal Comments

29. This is a financial report submitted as part of the governance process.

30. Under Section 1 of the Local Government Act 2003, the MOPAC as local authority defined under s23 of that Act, may borrow money for any purpose relevant to its functions under any enactment, or for the purpose of the prudent management of its financial affairs.

31. The Mayor is required under s3 of the Local Government Act 2003 to determine how much money the GLA and each functional body (which includes the MOPAC) can afford to borrow. In complying with this duty, Regulation 2 of the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 requires the Mayor to have regard to the Prudential Code for Capital Finance in local Authorities when determining how much the MOPAC can afford.

32. The MOPAC delegates its responsibility for loans, borrowing and investing to its Chief Financial Officer, who as the s127 officer is responsible for the proper administration of the MOPAC's financial affairs, and must act in accordance with various provisions including the Home Office Financial Management Code of Practice for the Police Service of England & Wales and the CIPFA Code of Practice for Treasury Management in Local Authorities.

33. The MOPAC Treasury Management Policy 2014/15 further advises on roles and responsibilities of the MOPAC Chief Financial Officer, and regulation 6.13 of the MOPAC's Financial Regulations requires the MOPAC Chief Finance Officer to ensure the DMPC is kept advised of treasury management activity on a regular basis.

34. This report discharges the requirements set out above.

Equalities Comments

35. Consideration is given to the requirements of equality legislation through the Ethical Investment Policy whereby best practice standards are promoted.

List of Background/Supporting papers

Treasury Management Strategy 2014/15 (DMPCD 2014-031)

MOPAC and GLA Shared Services (DMPC 2013 085)

Treasury Management Strategy 2013-14 Revised (DMPC 2013-086)