MOPAC | MAYOR OF LONDON
OFFICE FOR POLICING AND CRIME

REQUEST FOR DMPC DECISION – PCD 58

Title: Treasury Management 2015-16 Outturn Report

Executive Summary:

DMPC is asked to note the progress and performance of Treasury Management in 2015-16 and to approve proposed revisions to the 2016/17 investment strategy.

In 2015-16 investment income was £1.8m against budget of £0.8m at an average rate of return of 0.63%. Debt interest expenditure was below budget at £7.2m due to no new long term debt being undertaken. The weighted average borrowing rate of all long term loans (weighted by size of loan and the rate of interest paid) at 31 March 2016 was 3.98%.

All investment and borrowing activity during 2015-16 was undertaken within the guidelines and objectives set out in the relevant policy and investment and borrowing strategies, except for a breach in relation to counterparty concentration limits for Lloyds Bank at the end of the year.

Recommendation:

The DMPC is asked to

1. Note the 2015/16 treasury management outturn results against the 2015/16 Treasury Management Strategy Statement (TMSS).
2. Note the breach of the TMSS, in relation to counterparty concentration limits for Lloyds Bank, which were exceeded over the period 28 March 2016 to 12 April 2016. No losses arose from this breach of the TMSS, and details of the sums involved and reasons for the breach are set out in Appendix 1, paragraphs 3 to 11.
3. Approve revisions to the 2016/17 Group Investment Syndicate (GIS) Investment Strategy, as set out in Appendix 1, paragraphs 12 to 17. This Strategy was originally approved as part of the Treasury Management Strategy Statement for 2016/17 approved by MOPAC on 17 March 2016 (DMPCD 2016 47).

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. Any such interests are recorded below.

The above request has my approval.

Signature	**Date**
Sophie Linden	3/10/2016.

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

Decision required – supporting report

1. Introduction and background

1.1. The CIPFA TM Code recommends that organisations be updated on treasury management activities regularly (at least a Strategy, Mid-year and Annual performance reports). This report therefore meets these requirements with regard to an annual report, and ensures MOPAC is implementing best practice in accordance with the TM Code.

1.2. The day to day management of the treasury management function is delivered by the GLA Group Treasury team under a shared service arrangement with the GLA. GLA Group Treasury also manages the Group Investment Strategy (GIS), of which the MOPAC Chief Finance Officer is a syndicate director. By being part of the GIS MOPAC's cash balances are pooled with other funds which allows greater investment options, improves diversification, liquidity and returns.

1.3. The annual report at Appendix 1 has been prepared by GLA Group Treasury, and provides details of performance against the TMSS 2015/16, approved by MOPAC on 26 March 2015 (DMPCD 2015 39). The report provides a review of investment performance for 2015/16, together with a summary of long-term borrowing, set in the context of the general economic conditions prevailing during the year. It also reviews specific Treasury Management prudential indicators defined by the Code and approved by the Authority in the TMSS.

2. Issues for consideration

2.1. 2015-16 Outturn Performance

<u>Investment</u>

2.1.1. The average return on investment was 0.63%. This compares favourably with the London Interbank BID (LIBID) 3 month rate benchmark of 0.45%. This resulted in additional income of £1m above the budget of £800k due to both a historic budget (now adjusted in the 2016/17 budget), higher cash balances and better returns from utilising the Group Investment Syndicate (GIS).

<u>Debt Management</u>

2.1.2. As planned no new borrowing took place in 2015/16, and as scheduled, borrowing reduced by £14.5m from £190.4m at the start of the year to £175.9m at 31 March 2016.

2.1.3. The cost of borrowing was below the budget of £9.4m and on track with forecast at £7.2m due to no new long term debt being undertaken. The weighted average cost of borrowing of all long term loans as at 31 March 2016 was 3.98% (3.84% as at 31 March 2015).

<u>Compliance</u>

2.1.4. All treasury activities met the Treasury indicators set in the TMSS, and borrowing was within the borrowing limits set by the Mayor for MOPAC. MOAPC CFO confirms that, throughout the period, all treasury activities have been conducted within the parameters of the TMSS 2015/16, alongside best practice suggested by the CIPFA TM Code and Central Government, except in respect of the period 28 March 2016 to 12 April 2016.

2.1.5. The GIS counterparty concentration limits for Lloyds Bank were exceeded over the period 28 March 2016 to 12 April 2016. No losses arose from this breach of the TMSS. Details of the sums involved and reasons for the breach are set out in the GLA Group Treasury report at Appendix 1 paragraphs 3 to 11.

Prudential Indicators

2.1.6. Appendix 1 includes the maturity profile for the borrowing portfolio, and performance against the Prudential Indicators set as part of the 2015-16 TM Strategy. All indicators were met.

2.2. GIS Strategy

2.2.1. The GLA Group Treasury report at Appendix 1 also sets out a proposed amendment to the TMSS 2016/17, approved by GIS Syndics. This introduces the Residential Mortgage Bonds sector as part of the MOPAC's counterparties list for investment purposes. It is intended that the GLA test this revised strategy in their own name before proposing adoption by MOPAC and the GIS. Any proposed use of this instrument will require DMPC approval prior to implementation.

2.2.2. As noted above, the shared service with the GLA on treasury management, delivered by GLA Group Treasury, has been in place since 2012/13. Since its introduction the service provided has been developed to broaden the GIS. The reports provided by GLA Group Treasury to support reporting to Members have also been developed and now all GIS members use a standard report template.

2.3. Member Treasury Management Training

2.3.1. The TM Code states that Members (in the case of MOPAC the DMPC) have a personal responsibility for treasury matters. To support Members in meeting this responsibility, and ensure members are appropriately up to date with treasury matters, a training session has been developed by GLA Group Treasury. The training sets out key information for Members, allows for a Question and Answer session and has been provided to the DMPC.

2.4. EU Referendum

2.4.1. Following the outcome of the recent EU referendum the UK has lost its top AAA credit rating from ratings agency Standard & Poors (S&P). S&P had been the only major agency to maintain a AAA rating for the UK. It has now cut its rating by two notches to AA. S&P said that the referendum result could lead to "a deterioration of the UK's economic performance, including its large financial services sector". Rival agency Fitch lowered its rating from AA+ to AA, forecasting an "abrupt slowdown" in growth in the short-term. Moody's has since cut the UK's credit rating outlook to negative

2.4.2. This in turn has reduced the GLA's S&P rating from AA+ to AA. The consequences of this for treasury activity is being evaluated

3. Financial Comments

3.1. The cost of borrowing and the minimum revenue provision for 2015/16 were £7.2m and £28.5m respectively and within the 2015/16 budget. Interest received in 2015/16 was £1m above the budget of £0.8m. The on-going implications of these underspends has been included in the 2016/17 budget.

3.2. The impact of the EU referendum, funds for investment, borrowing and cashflow will all be reviewed as part of the Budget Submission.

4. Legal Comments

4.1. Under Section 1 of the Local Government Act 2003, 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.

4.2. 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 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 MOPAC can afford.

4.3. MOPAC's scheme of delegation provides that the Chief Finance Officer, as the s127 officer, is responsible for the proper administration of the MOPAC's financial affairs.

4.4. An investment strategy statement must be completed as part of risk management and good governance. The report is submitted in compliance with TMSS and DCLG requirements in this regard

5. Equality Comments

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

6. Background/supporting papers

6.1. Appendix 1

Public access to information Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FOIA) and will be made available on the MOPAC website following approval. If immediate publication risks compromising the implementation of the decision it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary.
Part 1 Deferral: Is the publication of Part 1 of this approval to be deferred? NO If yes, for what reason: Until what date:
Part 2 Confidentiality: Only the facts or advice considered as likely to be exempt from disclosure under the FOIA should be in the separate Part 2 form, together with the legal rationale for non-publication. Is there a **Part 2** form –NO

ORIGINATING OFFICER DECLARATION:

	Tick to confirm statement (✓)
Head of Unit: The Interim Finance Director has reviewed the request and is satisfied it is correct and consistent with the MOPAC's plans and priorities.	✓
Legal Advice: Legal advice is not required.	✓
Financial Advice: The Strategic Finance and Resource Management Team has been consulted on this proposal.	✓
Equalities Advice: Equality and diversity issues are covered in the body of the report.	✓

OFFICER APPROVAL

Acting Chief Executive 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** R. Lawrence **Date** 5/10/2016

Appendix 1

GREATER LONDON AUTHORITY

GROUP TREASURY

Treasury Management Outturn for 2015-16 - MOPAC

Executive Summary:

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

Treasury activity has seen the Authority's investments outperform its investment benchmark by 0.18% during 2015-16. Total invested balances have decreased from £184.66m at the 31 March 2015 to £36.89m at 31 March 2016.

The Authority's loan borrowing levels have reduced from £190.38m at the 31 March 2015 to £175.92m at 31 March 2016.

All 2015/16 Treasury activity has been within the boundaries and levels set by the Authority in its Treasury Management Strategy Statement on 26 March 2015, DMPCD 2015 039, except during the period 28 March 2016 to 12 April 2016. Further details are provided at paragraphs 3 to 11.

Recommendation:

That the following is noted:

- The 2015/16 Treasury outturn results against the 2015/16 Treasury Management Strategy Statement, as approved on the 26 March 2015, DMPCD2015 039.
- Non-compliance with the 2015/16 Treasury Management Strategy Statement. Further details are provided at paragraphs 3 to 11.

That the following is approved:

- Revisions to the 16/17 GIS Investment Strategy. This Strategy was originally approved as part of the Treasury Management Strategy Statement for 2016/17 on 17 March 2016, DMPCD 2016 47.

Introduction/Background

1 This report provides details of all investment and borrowing activities for the period from 1 April 2015 to 31 March 2016 and highlights relevant issues currently under consideration by officers. It provides a comparison of the closing investment and debt positions as at 31 March 2016 with the opening position as at 1 April 2015.

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

Compliance with the 2015/16 Treasury Management Strategy Statement

3 The Director of Police Resources and Performance confirms that, throughout the period, all treasury activities have been conducted within the parameters of the 2015/16 Treasury Management Strategy Statement (TMSS), alongside best practice suggested by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Central Government, except in respect of the period 28 March 2016 to 12 April 2016.

4 The GIS counterparty concentration limits for Lloyds bank were exceeded over the period 28/3/16 to 12/4/16. No losses arose from this breach of the TMSS.

5 Over the period in question, the CDS overlay was not properly applied, meaning that the limits for Lloyds Bank were not adjusted downwards to reflect CDS spreads breaching barrier levels. At this point, new investment should have been suspended as the enhanced overnight limit fell from 25% to 10% reflecting a one notch fall from "red" to "green" in the Capita methodology.

6 The following deposits were made in breach of the GIS investment strategy as a result:

Date of deposit	£m
30/03/2016	**25.00**
04/04/2016	**90.00**
07/04/2016	**100.00**
08/04/2016	**10.00**
11/04/2016	**20.00**

7 Although the transactions are large, we should note that Lloyds are the provider of the call account which currently forms a key part of our liquidity strategy and this period was volatile with significant deposits and withdrawals from participants. The net impact of these transactions was a £60m increase in exposure, or 3% of average balances for the period, within the unadjusted, ratings-based limits the team believed to be in force. It was also the case that the over-exposed amounts were available on immediate notice.

8 All ratings (as opposed to CDS overlay) updates were implemented as usual and no other counterparty exposures were affected.

9 The error was detected on 12/4/2016 at which point limits were adjusted and Lloyds exposure was found to be 24%, of which 15% was overnight. The CDS overlay would have reduced the limit from 25% to 10%, so new investments were immediately suspended. The team considered the CDS environment and concluded the recent movements were a consequence of Brexit fears rather than a reflection of reduction in short term credit worthiness. The investment decision was therefore taken not to take steps towards reduction of existing exposures. The team monitored CDS spreads daily, which improved day by day and returned within range by 18/04/16. GIS members were informed of this breach and explanations made to each member of the GIS.

10 Although there were no actual consequences of the breach, nor (in the opinion of the GIS) any increase in credit risk over the period in question, a major review has been undertaken and a series of lessons have been learnt.

11 These lessons learnt were discussed at the GIS meeting on 6 June. Following these discussions, the lessons learnt have been and are being implemented, with consequential proposed revisions to the Investment Strategy set out at Appendix 1 paragraphs 29 and 40.

Revisions to 2016/17 GIS Investment Strategy

12 The GIS strategy is re-presented in a shorter and more focussed fashion, followed by explanatory notes for board papers if required for public or non-specialist use. The purposes of this are to:

a. *Streamline the document for use as a definitive working tool by officers to avoid version control issues or ambiguity; and*

b. *Facilitate sharing with external managers to ensure they can easily align their proposals for sub-portfolios the GIS may delegate (such as Residential Mortgage Backed Securities "RMBS") with the overall strategy.*

13 Reporting ambiguities relating to exceptions are eliminated and the levels of discretion for both exception resolution, suspension of counterparties and implementation of the CDS overlay are now set out clearly.

14 Provisions relating to the duties and discretions of external managers are made clear.

15 The risk appetite implied by the previous strategy is stated explicitly.

16 A number of minor changes and simplifications are also made:

a. Permitted duration limits for certain types of bond, including UK Gilts, have been reduced. A uniform limit of 2 years applies for internally managed investment and 5 for externally managed.

b. Following a review of a prospective new participant's strategies, the use of covered bonds and repurchase agreements has been added as forms of secured lending alongside RMBS. These transactions offer additional security but the enforcement of such security does involve operational risks, therefore a prudent view has been taken in respect of limits.
    i. *In general no counterparties may be used who do not themselves meet GIS investment criteria, however their exposure limits may be increased by up to 10% to reflect the additional level of security.*
    ii. *Unrated counterparties may be used for repo transactions of less than one year provided the repo is appropriately over-collateralised with UK government securities. This is currently intended to unlock the opportunity to lend to pension funds engaged in liability management activities, with the limit per counterparty being 2.5% and an aggregate limit of 20%.*

c. The general framework for RMBS is set out (NB pending appointment of the successful manager in the next 2 weeks, a detailed RMBS mandate will be proposed to the Syndics before investment)

d. The overall limit on non-financial corporate bonds (previously 20%) has been removed as it is arguably redundant

e. Equivalence tables for ratings funds and structured finance products, in addition to the existing table for issuer credit ratings are set out

f. The use of the "Blue" credit band has been withdrawn in light of regulatory considerations around mandatory losses for bank creditors; this previously provided enhanced limits for banks in significant UK government ownership.

17 A full version of the revised 2016/17 GIS Investment Strategy is provided at Appendix 1

The Economic Background

18 Treasury performance and effective management of risk around borrowing and investments and cash flow management are influenced by interest rate and inflation rate movements, market volatility, domestic growth expectations and global growth expectations.

19 Global growth throughout 2015 remained subdued at some 3.1% while UK economic growth (GDP) fell from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4. Annual inflation during 2015 was zero against a target of 2%, as measured by the Consumer Prices Index. Equity and bond price volatility was high as markets reacted to concerns around a fall in China's economic growth; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; low oil prices and continuing Eurozone growth uncertainties.

20 The Bank of England base rate has remained at its historic low of 0.5% throughout the year; it has now remained unchanged for seven years. Markets' expectations of an interest rate rise have moved from quarter 1 2016 at the start of the year to quarter 1 2017 by the end of the year, with a raise of only 0.25% to 0.75% expected.

21 Against such an economic background, deposit rates have remained depressed during the year, making it difficult to achieve good returns. Borrowing rates have also been low, ranging from 1 year PWLB maturity certainty rates at just above 1% to 50 year PWLB maturity certainty rates at circa 3.25%, creating opportunities for borrowing at good rates. However, the difference between borrowing and investment rates is such that there is a significant cost of carry on external borrowing.

Current Treasury Management Position

22 The table below shows the current Treasury management position.

Current Treasury Position

	Actual as at 31 March 2015		TMSS Forecast to March 2016		Actual as at 31 March 2016	
	£m	Rate %	£m	Rate %	£m	Av. Rate
External Borrowing						
Long Term Borrowing: PWLB	190.38	3.84	175.92	3.98	175.92	3.98
Long Term Borrowing: Market Loans	0.00	0.00	0.00	0.00	0.00	0.00
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00	0.00
Total External Borrowing (A)	190.38	3.84	175.92	3.98	175.92	3.98
Other Long Term Liabilities						
PFI Liability	86.89		82.30		82.25	
Finance Lease liability	5.68		5.50		5.53	
Total Other Long Term Liabilities(B)	92.57		87.80		87.78	
Total Gross Debt (A+B)	282.95		263.72		263.70	
Capital Financing Requirement	670.61		645.58		647.93	
Less Other Long Term Liabilities	92.57		87.80		87.78	
Underlying Capital Borrowing Requirement (C)	578.04		557.78		560.15	
Under/(Over) Borrowing (C-A)	387.66		381.86		384.23	
Investments (D)	184.66	0.46	4.07	0.63	36.89	0.63
Total Net Borrowing (A-D)	5.72		171.85		139.03	

23 Further analysis of borrowing and investments is covered in the following two sections.

Borrowing Activity

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

25 During 2015/16, Private Financing Initiative (PFI) liabilities were reduced by £4.64m from £86.89 as at the 31 March 2015 to £82.25m as at the 31 March 2016. Finance lease

liabilities were also reduced from £5.68m as at the 31 March 2015 to £5.53m as at the 31 March 2016.

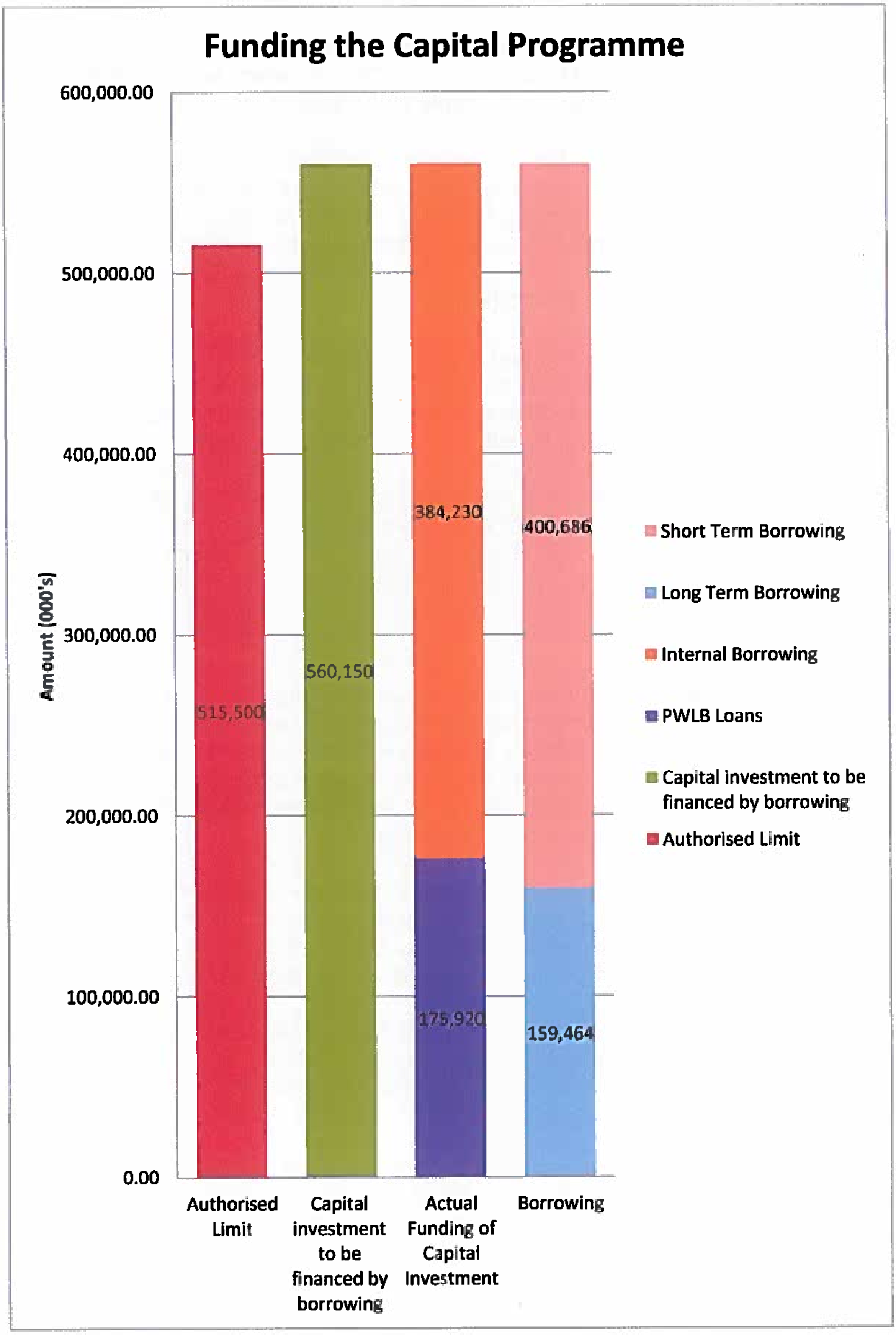
26 No new external loan borrowing was taken out during 2015/16. Instead £14.46m of external loan borrowing was repaid, reducing the total borrowing to £175.92m.

27 When market conditions are favourable long term loans can be restructured to:

- generate cash savings
- reduce the average interest rate
- to enhance the balance of the portfolio by amending the maturity profile and/or the level of volatility. (Volatility is determined by the fixed/variable interest rate mix.)

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

29 The graph below compares the maximum the Authority could borrow in 2015-16 with the 'Capital Investment to be financed by borrowing' at 31 March 2016 and the actual position of how this is being financed at 31 March 2016. The final column shows the split between short (internal and external borrowing with duration of less than one year) and long term borrowing.


Funding the Capital Programme
600,000.00
500,000.00
400,000.00
300,000.00
200,000.00
100,000.00
0.00
Amount (000's)
515,500
560,150
384,230
175,920
400,686
159,464
Short Term Borrowing
Long Term Borrowing
Internal Borrowing
PWLB Loans
Capital investment to be financed by borrowing
Authorised Limit
Authorised Limit
Capital investment to be financed by borrowing
Actual Funding of Capital Investment
Borrowing

30 The graph shows that the Authority's current capital investment that is being funded via external borrowing, as at the 31 March 2016, is £175.92m, which is £339.580m below the Authorised Borrowing Limit set for the Authority at the start of the year.

31 In addition, the graph shows how the Authority is currently funding its borrowing requirement. As at 31 March 2016, the Authority was using £384.23m of internal borrowing to finance capital investment. Internal borrowing is the use of the Authority's surplus cash to finance the borrowing liability instead of borrowing externally.

Future of the Public Works Loans Board (PWLB)

32 In the TMSS 2016/17 it was advised that the governing structure of the PWLB was to be the subject of consultation, but that no date had been set for that consultation. This position has now changed. On the 19 May 2016, HM Treasury published a consultation document on the future of the PWLB, with a closing date of the 3 August 2016.

33 Under the consultation document, it is proposed to abolish the PWLB (the statutory body consisting of twelve appointed Commissioners) and transfer its powers to the Treasury. As these proposed changes are around changes to the governance structure, they should not have any impact on the Authority's borrowing activity.

Investment Governance

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

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

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

37 Additionally, the Authority may invest sums independently of the GIS, for instance if the Authority identifies balances which are available for longer term investment. Such investments must remain within the parameters of the GIS Investment Strategy, except that there shall be no requirement to maintain a weighted average maturity which does not exceed three months. However, each participant can place a limit on the duration of these longer term investments. For 2015/16, the Authority opted not to enter into any investments longer than 364 days in its own name, wishing to limit counterparty risk and liquidity risk.

38 At no time does the GIS Investment Strategy conflict with the Authority's TMSS.

39 The Authority's TMSS adheres to the CIPFA Prudential Code investment principle of placing security above liquidity and investment yield and then placing liquidity above

investment yield. This is commonly known as SLY. As such, the Authority maintains a low risk appetite consistent with good stewardship of public funds.

Investment Balances

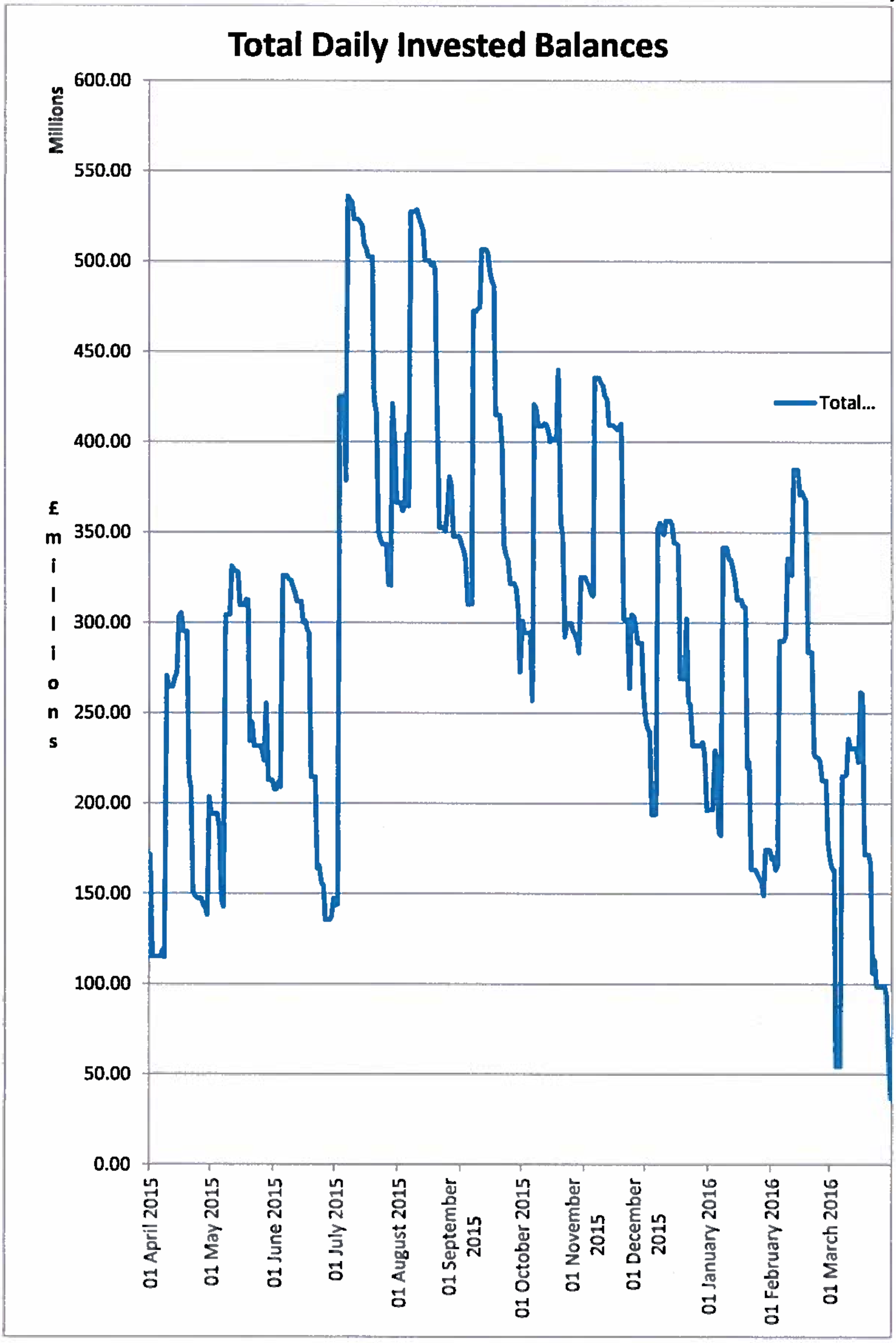
40 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decision to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are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

Core Funds and Expected Investment Balances

	Actual as at the 31 March 2015 £m	TMSS Forecast to March 2016 £m	Actual as at the 31 March 2016 £m	2015-16 Variance between Forecast and Year End Actual £m
Fund balances/reserves	419.40	279.80	297.92	18.12
Provisions	261.70	99.89	62.83	-37.06
Other/Capital Reserve	37.20	2.50	4.50	2.00
Total Core Funds	718.30	382.19	365.25	-16.94
Working Capital Surplus	-145.98	3.73	55.86	52.13
Under/(over) borrowing	387.66	381.86	384.22	2.36
Investments	184.66	4.07	36.89	32.82

41 Investment balances as at 31 March 2016 were £36.89m, this being a decrease of £147.77m over year end balances as at 31 March 2015.

42 The graph below shows the levels and movements in investment balances between 31 March 2015 and 31 March 2016. Fluctuations reflect changes in cash flow needs over the year, but throughout 2015-16 there was circa £35m of cash balances which were not required for daily needs and therefore could be regarded as 'core' cash and available for investment throughout the year.



Investment Performance

43 The Authority has outperformed its investment benchmark by 0.18% during 2015/16. It achieved a cumulative weighted average yield of 0.63% on daily balances against a cumulative weighted average 3 month LIBID of 0.45%. Throughout the period, the

Authority maintained its liquidity target of a weighted average maturity (WAM) of not more than 3 months.

44 This performance has been achieved despite low investment yields resulting from

- an uncertain economic future, which has kept the Bank of England interest rate low and

- a tightening regulatory framework, which has resulted in the Banks cutting their call account rates, as they lose their appetite for such funds, because of the need to meet more stringent leverage and liquidity coverage ratios.

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

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

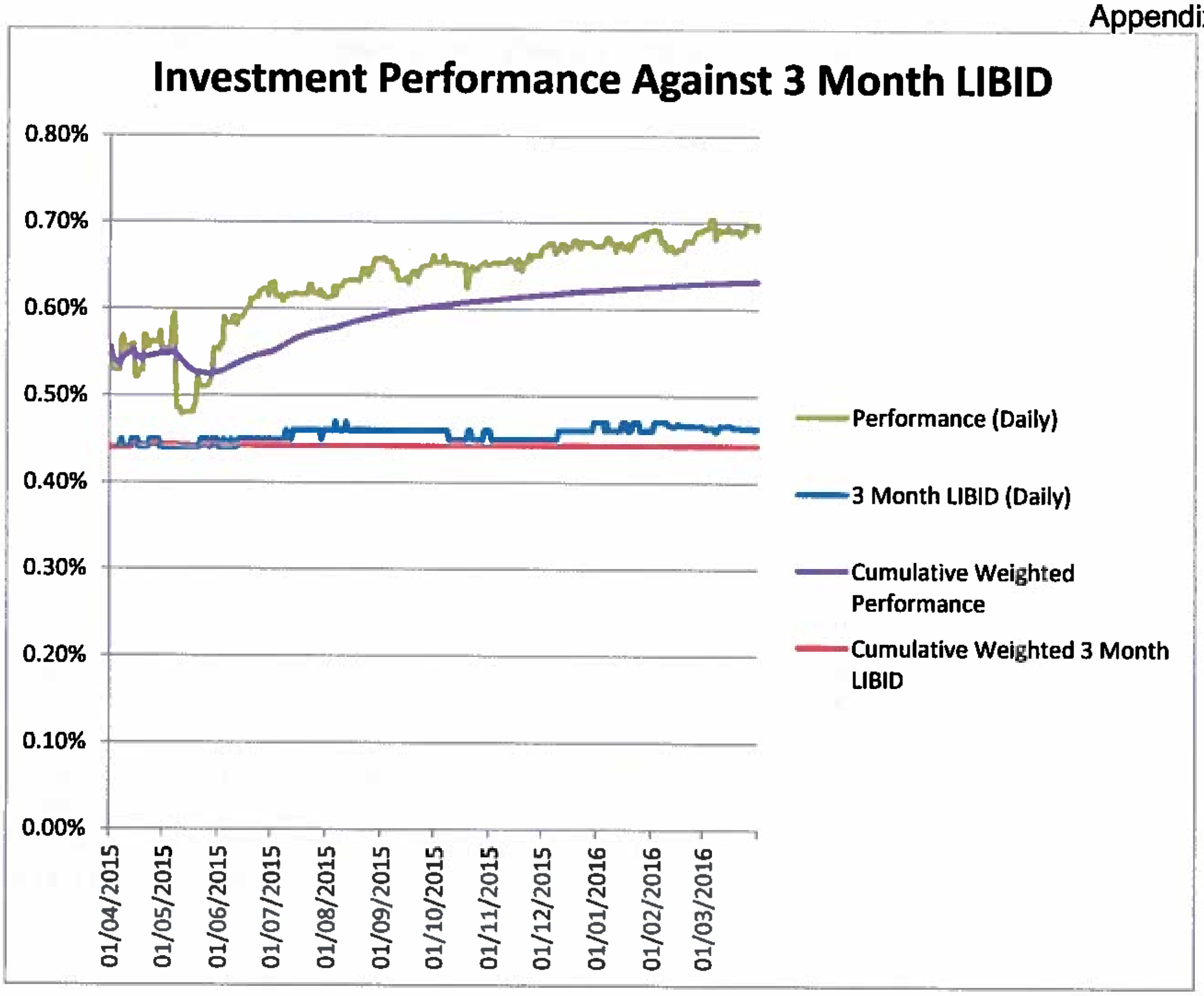
a. Using the strength of the GIS's £2.2bn investment balances to obtain higher than average rates without increasing risk

b. Creating a well-diversified portfolio by country, by counterparty and by credit rating. In particular, counterparty diversification has increased, as a result of moving some balances away from Lloyds Bank, following the loss of its quasi-government status on the 15th May 2015, as a result of the Government's announcement to sell its shareholding in Lloyds.

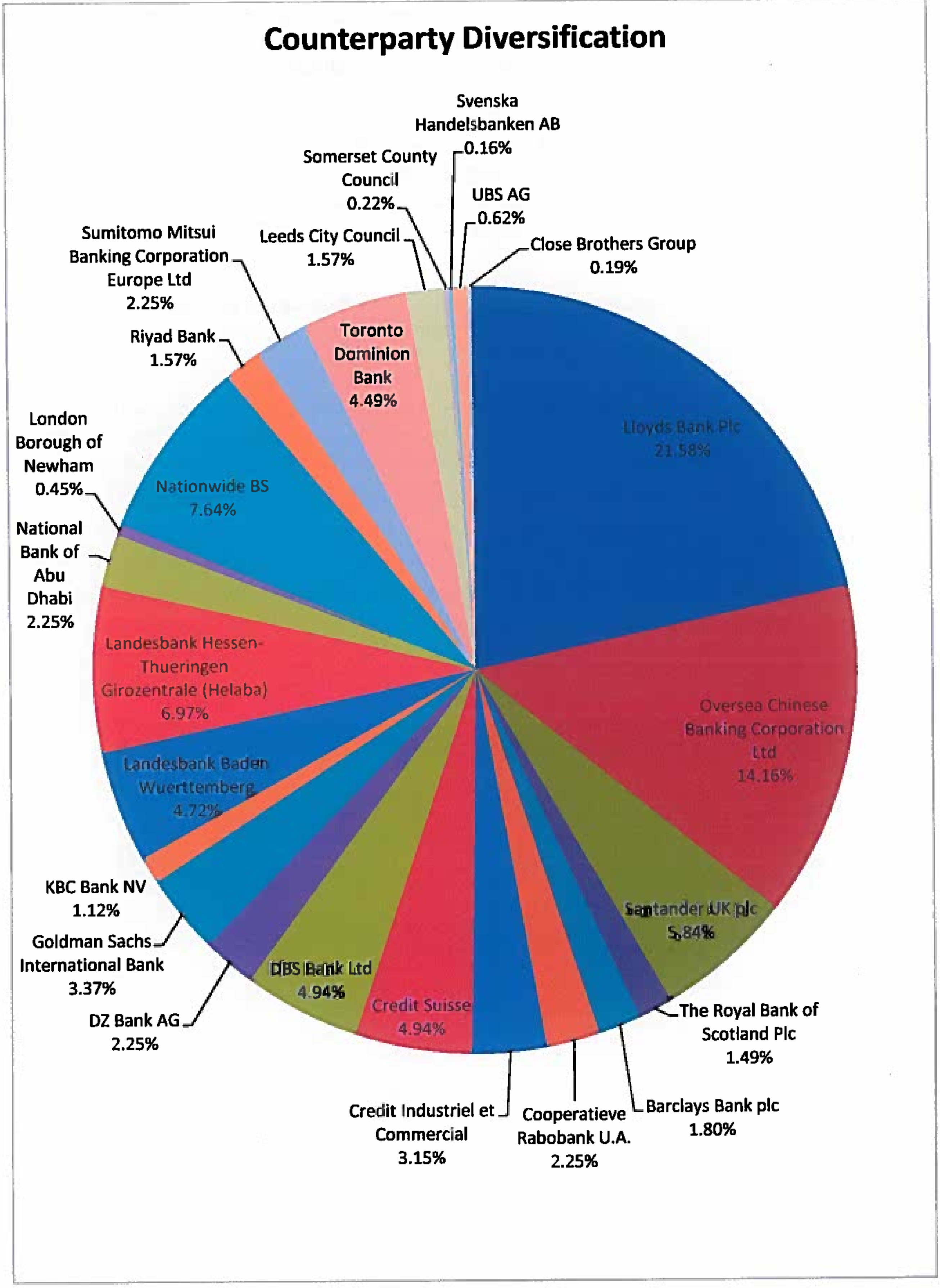
c. Seeking to invest in higher yielding longer dated instruments, while keeping the WAM within the 15/16 GIS Investment Strategy requirement that the WAM should not exceed 3 months.

d. Monitoring market activity and proactively seizing investment opportunities

47 The outperformance described above is shown in the graph below in which the Authority's annualised outperformance both for 'on the day' and for 'cumulative weighted average for the year' is shown.



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


Counterparty Diversification
Svenska Handelsbanken AB 0.16%
Somerset County Council 0.22%
UBS AG 0.62%
Sumitomo Mitsui Banking Corporation Europe Ltd 2.25%
Leeds City Council 1.57%
Close Brothers Group 0.19%
Riyad Bank 1.57%
Toronto Dominion Bank 4.49%
Lloyds Bank Plc 21.58%
London Borough of Newham 0.45%
Nationwide BS 7.64%
National Bank of Abu Dhabi 2.25%
Landesbank Hessen-Thueringen Girozentrale (Helaba) 6.97%
Oversea Chinese Banking Corporation Ltd 14.16%
Landesbank Baden Wuerttemberg 4.72%
KBC Bank NV 1.12%
Santander UK plc 5.84%
Goldman Sachs International Bank 3.37%
DBS Bank Ltd 4.94%
Credit Suisse 4.94%
DZ Bank AG 2.25%
The Royal Bank of Scotland Plc 1.49%
Credit Industriel et Commercial 3.15%
Cooperatieve Rabobank U.A. 2.25%
Barclays Bank plc 1.80%

49 In the 15/16 TMSS, the possibility was raised of counterparties falling into a lower durational banding and even becoming 'no colour' (falling outside the permitted investment range) under the Capita Credit Methodology, as Rating Agencies unwound their positions adopted in response to the 2008-09 financial crisis. In particular, it was thought that the removal of implied sovereign support could result in counterparties falling into a lower investment band. However, these fears have proved to be unfounded. By June 2015, all three Credit Rating Agencies had completed their credit reviews of UK institutions caused by the removal of implied sovereign support, arising from the move away from 'bail-out' by Governments to 'bail-in' by depositers. The impact has been three-fold:

a. Sovereign credit rating issues have been reduced in significance for investment decisions – the focus is now primarily on the entity itself as a credit worthy institution to lend money to.

b. Entity credit rating changes have been, by and large, minimal with changes in ratings being 'watches' rather than wholesale downgrades. This is largely because the strengthening of the balance sheets of financial institutions, through the tighter regulatory frameowrk, has offset the removal of implied sovereign support.

c. The Capita Asset Services, Treasury Solutions, counterparty list has continued to be a practical, workable counterparty list, with security as the primary driving factor.

Treasury Management Budget

Treasury Management Budget

	Actual as at the 31 March 2015 £m	TMSS Forecast to March 2016 £m	Actual as at the 31 March 2016 £m	2015-16 Variance between Forecast and Year End Actual £m
Interest payable (excl. PFI & Finance Liabilities interest payable)	7.79	7.22	7.22	0.00
Interest Receivable	-1.76	-0.80	-1.89	-1.09
Minimum Revenue Provision	30.21	28.50	28.47	-0.03
Other	0.00	0.00	0.00	0.00
Total	36.24	34.92	33.80	-1.12

50 The small decrease in interest payable between years reflects the repayment of PWLB loans. Interest receivable held up well in a low interest rate environment, largely due to high investment balances throughout the year, with only a sharp fall at the end of the year.

CIPFA Prudential Code Indicators and Treasury Management Limits

Background

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

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

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

a. Capital expenditure plans

b. External debt

c. Treasury Management

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

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

Capital Expenditure

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

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

Capital Expenditure

	2014/15 Actual £m	TMSS Forecast to March 2016 £m	2015/16 Actual £m	2015-16 Variance between Forecast and Year End Actual £m
Total Capital Expenditure In Year	199.43	248.70	237.59	-11.11

58 The capital expenditure for 2015/16, at £237.59m, was £11.11m less than that expected at the start of the year.

Capital Financing Requirement

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

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

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

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

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

Capital Financing Requirement (CFR)

	Actual as at the 31 March 2015 £m	TMSS Forecast to March 2016 £m	Actual as at the 31 March 2016 £m	2015-16 Variance between Forecast and Year End Actual £m
Total CFR	670.61	645.58	647.93	2.35

64 The capital financing requirement is in line with expectations.

External Debt Prudential Indicators

Authorised Limit for External Debt

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

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

67 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

	2015-16 Authorised Limit £m	Actual External Debt as at 31 March 2016 £m	Headroom £m
Borrowing	515.50	175.92	339.58
Other long term liabilities	87.80	87.78	0.02
Total	603.30	263.70	339.60

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

Operational Boundary for External Debt

69 The operational boundary is based on the same estimates as the authorised limit. However, it reflects an estimate1of the most likely prudent but not worse 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.

70 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

	2015-16 Operational Boundary £m	Actual External Debt as at 31 March 2016 £m	Headroom £m
Borrowing	390.50	175.92	214.58
Other long term liabilities	87.80	87.78	0.02
Total	478.30	263.70	214.60

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

Gross Debt and the Capital Financing Requirement

72 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.

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

Gross Debt and the Capital Financing Requirement (CFR)

Actual External Debt as at 31 March 2016 £m	Preceding Year CFR £m	2015-16 Actual Additional CFR £m	2016-17 Estimated Additional CFR £m	2017-18 Estimated Additional CFR £m	Total CFR over 4 years £m	Amount Gross Debt < Total CFR over 4 years £m
263.70	670.61	0.00	0.00	0.00	670.61	406.91

74 Gross debt, as at 31 March 2016, is £406.91m less than the estimated total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This indicates that the Authority's current financial strategy is prudent and sustainable, in that borrowing is only used to fund capital expenditure in the medium term.

Affordability Prudential Indicators

Ratio of Financing Costs to Net Revenue Stream

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

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

Financing Costs to Net Revenue Stream

	Actual as at the 31 March 2015 %	TMSS Forecast to March 2016 %	Actual as at the 31 March 2016 %	2015-16 Variance between Forecast and Year End Actual %
Total	1.90	2.00	1.91	-0.09

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

Incremental Impact of Capital Investment Decisions on the Council Tax

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

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

Incremental Impact on Council Tax

	Actual as at the 31 March 2015 £	Actual as at the 31 March 2016 £
Council Tax Band D	1.09	1.51

80 The Authority's capital investment decisions in 2015/16 have had an incremental increase on Council Tax compared to 2014/15.

Treasury Management Prudential Indicator

81 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.

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

Treasury Management Limits on Activity

Fixed and Variable Rate Interest Rates Exposure

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

Fixed rate ratio:

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

Variable rate ratio:

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

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

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

84 To achieve certainty over its borrowing costs in support of prudent long term planning, the Authority has only ever entered into fixed rate loans; however, concerns over liquidity and credit risk mean that in practice all the Authority's investments mature within one year so are categorised as variable rate. The fixed rate ratio as at 31 March 2016 is 115%, reflecting the fact that borrowings are roughly four times greater than investments. The variable rate ratio is therefore -15%. If the variable rate ratio were positive, this would indicate that fluctuating rates could increase borrowing costs without being matched by increased investment income.

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

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

Limits for Maturity Structure of Borrowing

	TMSS Forecast to March 2016		Actual as at the 31st March 2015	Actual as at the 31st March 2016
	Upper Limit	Lower Limit		
	%	%	%	%
Under 12 months	100.00	0.00	7.59	9.35
12 months and within 24 months	100.00	0.00	8.64	9.35
24 months and within 5 years	100.00	0.00	29.69	30.50
5 years and within 10 years	100.00	0.00	15.76	12.51
10 years and above	100.00	0.00	38.32	38.28

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

Limits for Principal Sums Invested for Periods Longer than 364 days

87 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 Authorities 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

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

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

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

i. The Local Government Act 2003, section 15(1) requires an Authority to have regard to the Department for Communities and Local Government (DCLG) Guidance on Local Government Investments 2010, which requires firstly the achievement of security (protecting the capital sum from loss), then liquidity (keeping the money readily available for expenditure when needed), and then lastly investment yield. This investment strategy is endorsed by the Prudential Code. The Authority complies with this Guidance by adopting a low risk appetite in its TMSS.

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

91 The table below shows the full year 2015/16 investment portfolio of investments maturing after 364 days.

MOPAC element of long term cash investments of GIS pooled monies taken between 01/04/15 and 31/03/16

Date of Deal	Counter Party	£m	Interest Rate %	Maturity Date
20/05/2015	Oversea Chinese Banking Corporation	1.24	0.90	20/05/2016
Total		1.24		

New Long Term Borrowing taken between 01/04/15 and 31/03/16

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

93 No new long term borrowing was taken out during 2015/16.

GIS Investment Strategy 2016/17 [Revised July 2016]

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	121-150	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 22.0, may be used by external managers appointed in accordance with 18.0, 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:

Appendix 1

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 33.0	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_{mmf} or equivalent from other agencies per 37.0	NS	*Not permitted.*	20%
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%

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
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 meeting permitted maturity limits.	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

21.0 Individual maturity limit, internally managed instruments: ≤ 2 years

22.0 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]

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

24.0 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]

25.0 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)

26.0 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.

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

28.0 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%

29.0 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.

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

31.0 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.

32.0 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 [under review]

33.0 Maximum exposures to non-UK 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	Aa2

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 immediately to the Syndics.

35.0 If 5y CDS spreads for the relevant country's central government bonds exceed barrier levels from time to time agreed by the Syndics on the advice of Capita or the CIO, the aggregate exposure limit will normally be reduced to that of the lower rating, or in the case of a AA sovereign, further investment will be suspended. The CIO may postpone such adjustments in consultation with the Syndics.

36.0 The Participants recognise that the approach above does not perfectly mitigate geopolitical risks, therefore the CIO is empowered to suspend investment in any particular country should concerns arise. The use of this discretion will be reported immediately to the Syndics.

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 / OEIC Ratings		
Fitch	Moody's	S&P
AAA_{mmf}	Aaa-mf	AAAm

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 33.0	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
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 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.

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

4.0

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 30 June 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

17.0

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.

New instruments introduced since previous strategy

iv. Reflecting increased market risk and difficulties in diversifying, this strategy introduces the new and 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.

- 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.

20.0

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.

29.0

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.

39.0

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)

50.0

i. 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,