MOPAC | MAYOR OF LONDON

OFFICE FOR POLICING AND CRIME

REQUEST FOR DMPC DECISION – DMPCD 2016 022

Title: Treasury Management Outturn 2014-15 and Mid-Year Performance 2015-16

Executive Summary:

DMPC is asked to note the progress and performance of Treasury Management in 2014-15, and to 30 September 2015.

In 2014-15 investment income was £1.76m against budget of £0.8m at an average rate of return of 0.46%.

Debt interest expenditure was £7.8m against budget of £9m due to no new long term debt being undertaken. The weighted average of all long term loans (weighted by size of loan and the rate of interest paid) at 31 March 2015 was 3.84%.

In respect of 2015-16 to 30 September 2015 interest income for the first half year is £1m, and is ahead of the annual budget of £0.8m. Debt management costs for the period are £3.65m, and are forecast to be at the budget of £7.22m at year end.

All investment and borrowing activity during 2014-15 and to 30 September 2015 was undertaken within the guidelines and objectives set out in the relevant policy and investment and borrowing strategies.

Recommendation:

The DMPC is asked to note the activity and performance 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. Any such interests are recorded below.

The above request has my approval.

Signature **Date** 1/3/2016

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

Decision required – supporting report

1. Introduction and background

1.1. Under the Treasury Management Strategy Statement (TMSS) 2014-15 that the DMPC approved in May 2014 [DMPCD 2014-31] an annual report reviewing year end performance must be considered by the DMPC. Similarly, under the Treasury Management Strategy 2015-16 approved in March 2015 [DMPCD 2015 39] mid-year performance should also be reported to DMPC. This paper fulfils these requirements.

2. Issues for consideration

2.1. <u>2014-15 Outturn Performance</u>

2.1.1. Investment

The return on investment was 0.46%. This compares favourably with the London Interbank BID (LIBID) 3 month rate benchmark of 0.43%. This resulted in additional income of £1m above the budget of £800k due to both higher cash balances and better returns from utilising the Group Investment Syndicate (GIS).

2.1.2. Debt Management

As planned no new borrowing took place in 2014/15. Temporary loans of £50m were repaid, as was £19.5m of PWLB loan principal and local authority long term loans of £10m.
These repayments of £79.46m of existing loans resulted in the total debt portfolio reducing from £269.84m at the start of the year to £190.38m at 31 March 2015.

The cost of borrowing was £7.8m against the budget of £9m. The weighted average cost of borrowing of all long term loans as at 31 March 2015 was 3.84% (2.92% as at 31 March 2014).

2.1.3. Compliance

All transactions undertaken during the year met the criteria for lending to institutions set out in the TM Strategy 2014-15.

2.1.4. Prudential Indicators

Appendix 1 includes the maturity profile for the borrowing portfolio, and performance against the Prudential Indicators set as part of the 2014-15 TM Strategy. All indicators were met.

2.2. <u>2015-16 Performance to 30 September 2015</u>

2.2.1. Investment

The average rate of return was 0.60% compared with the LIBID 3 month benchmark of 0.45%, generating income of £1m. The annual budget for interest receivable is £0.8m.

2.2.2. Borrowing

There has been no new long term borrowing in the first six months of 2015-16, and due to loan repayments the total borrowing has reduced from £190.38m to £183.15m – a reduction of £7.2m

Borrowing costs for the first 6 months was £3.65m, and are forecast to be £7.2m against a budget of £7.2m.

2.2.3. Compliance

All transactions undertaken during the year met the criteria for lending to institutions set out in the TM Strategy 2015-16.

2.2.4 Treasury Management Prudential Code Indicators

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

2.3. Treasury Management Strategy 2016/17

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 2016/17. DMPC will be asked to consider and approve a 2016/17 strategy in March 2016.

3. Financial Comments

3.1. The cost of borrowing and the minimum revenue provision for 2014/15 were £7.8m and £30.3m respectively and within the 2014/15 budget. Interest received in 2014/15 was £1m above the budget of £0.8m.

3.2. To 30 September 2015 the cost of interest payable was £3.65m and forecast to be £7.2m. The minimum revenue provision is forecast to be within the budget of £28.5m. Interest receivable was £1m and is forecast to be £1.9m, above the annual budget of £0.8m.

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 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: Alex Anderson has reviewed the request and is satisfied it is correct and consistent with the MOPAC's plans and priorities.	✓
Legal Advice: The MPS legal team has been consulted on the proposal.	✓
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

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** 1/3/16

DMPCD 2016 22

Appendix 1

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

Introduction/Background

1 This report provides details of all investment and borrowing activities for the period from 1 April 2014 to 30 September 2015 and highlights relevant issues currently under consideration by officers. For 2014/15, the report provides a comparison of the closing investment and debt positions as at 31 March 2015 with the 2014/15 opening position as at 1 April 2014. For 2015/16, the report provides a comparison of the closing investment and debt positions as at 30 September 2015, with the 2015/16 opening position as at 1 April 2015 and a forecast to 31 March 2016 or beyond where relevant.

2 The Director of Police Resources and Performance confirms that, 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 2014/15 Treasury Management and Annual Investment Strategy or the 2015/16 Treasury Management and Annual Investment Strategy, alongside best practice suggested by the Chartered Institute of Public Finance and Accountancy (CIPFA) and Central Government.

3 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 investment return.

4 It should be noted, however, that from the 1 May 2014 until June 2015, the Authority's Investment Strategy, exceptionally, did not authorise participation in the GLA GIS. Instead, the GLA Treasury invested the Authority's money in line with the Investment Strategy contained within the Treasury Management Strategy Statement (TMSS) approved by the DMPC on the 1 May 2014 (DMPCD 2014-031). To allow GLA treasury officers the time to arrange operational facilities to be put in place in order to operate this 2014/15 TMSS, implementation of this strategy did not occur until 3 July 2014. The Authority returned to fully participating in the GIS Investment strategy in June 2015, after it became apparent that investment returns were more likely to be maximised by adopting the GIS Investment Strategy.

The Economic Background provided by GLA Treasury Group in January 2016

5 Following the setting of the 15/16 Treasury Management Strategy Statement in the first quarter of 2015, the UK economy continued to experience steady growth against a backdrop of low inflation. However, this could not be said of the global economy, as its growth began to slow. By September 2015, this slowdown in growth was leading some economists to consider the possibility of an emerging market crisis, as part three of a trilogy that began with the 'Anglo-Saxon' financial crisis of 2008-09 and transmuted into the Eurozone crisis of 2011/12.

6 By the start of 2016, the existence of a global economic market crisis is a generally accepted fact. Furthermore, this global economic market crisis appears to be deepening and creating uncertainty and fear, as evidenced by the extreme volatility in the financial markets in the first month of 2016.

7 The primary source of this global economic crisis is the deteriorating performance of the emerging world economies. Of the five Brics (Brazil, Russia, India, China and South Africa), China is much the most important emerging economy, but after some ten years of high debt fuelled growth, this growth has slowed significantly. As a result, demand for commodities has fallen away, but this fall in demand has occurred just as the supply of commodities has increased. With supply greater than demand, a

worldwide sharp fall in commodity prices has occurred, which in turn has caused a serious deterioration in those companies and countries dependent on revenues generated from the sale of commodities.

8 The countries dependent on oil revenues are also suffering. This is because of a sharp fall in oil prices caused by the OPEC oil producing members failing to reduce production to match the demand for oil.

9 If this is not enough, the European migrant crisis, the threat of Brexit and conflict in the Middle East has further added to global woes. As a result, the global economy only grew by 2.4% in 2015 and in January 2016, the World Bank cut its prediction of global growth from 3.3% to 2.9% for 2016 and from 3.2% to 3.1% for 2017.

10 Finally, the depth and breadth of the global economic deterioration has not left the industrialised economies unscathed. The Eurozone, continues to be beset by high unemployment and slow growth, with the European Central Bank's stimulus monetary policy, enjoying only limited success. It is true that during 2015, the UK and the USA enjoyed a steady recovery, from the benefits of low inflation, wage growth, and improved consumer demand and consumer confidence. So much so, that in December 2015, the FED increased short term rates to 0.25-0.5. However, the global downturn is now having a knock-on effect on the US and UK economies, with the Bank of England in January 2016 cutting the UK economy's forecast growth rate for 2016 from 2.5% to 2.2% in January 2016. This compares to a growth rate of 2.2% in 2015 and a growth rate of 2.9% in 2014. As a result, an interest rate increase in the UK is not expected in the immediate future.

11 This deteriorating outlook has several key treasury management implications:

- Higher quality counterparties for shorter time periods should continue to be preferred, especially against a possible backdrop of government debt to GDP ratios rising in some countries.

- Investment returns are likely to remain relatively low during 2016/17. In the UK, the base rate has remained at 0.5% since March 2009, with possible rises continually pushed back. A base rate rise is now forecast no earlier than the first quarter of 2017, and if a rise does occur, it is only expected to be an increase of 0.25% to 0.75%.

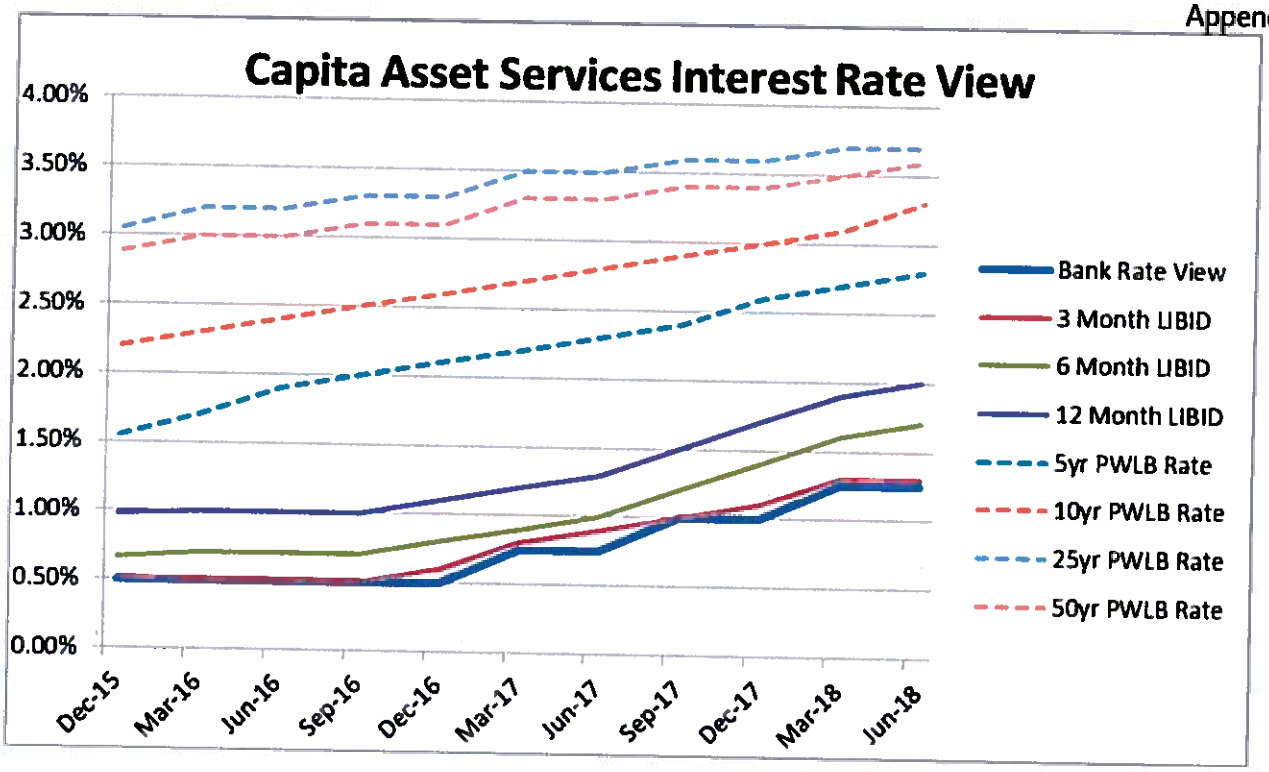
- Borrowing interest rates have and continue to be volatile, as alternating bouts of good and bad news have promoted optimism and then pessimism, in financial markets. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt.

- There will remain a cost of carry to any new borrowing, which causes an increase in investments, as this will incur a revenue loss between borrowing and investment returns

Prospects for Interest Rates

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

13 Capita Asset Services, Treasury Solutions, is the Authority's advisor, under the GLA Group Treasury Consultancy Services contract. The provision of interest rate forecasts is one obligation under this contract that Capita Asset Services, Treasury Solutions has to meet. Below is a central view for short term interest rates (Bank Rate) and longer term fixed interest rates, as provided by Capita Asset Services, Treasury Solutions, as at February 2016. The PWLB Rates shown are net of the 0.2% 'certainty rate' discount.



Current Treasury Management Position

14 The table below shows the current Treasury management position.

Current Treasury Position

Current Treasury Management Position	Actual as at 31 March 2014		Actual as at 31 March 2015		Actual as at 30 September 2015	
	£m	Av. Rate	£m	Av. Rate	£m	Av. Rate
External Borrowing						
Long Term Borrowing	219.84	3.60%	190.38	3.84%	183.15	3.91%
Short Term Borrowing	50.00	0.57%	0.00	-	0.00	-
Total External Borrowing (A)	269.84		190.38		183.15	
Other Long Term Liabilities						
PFI Liability	91.41		86.89		84.57	
Finance Lease Liability	5.81		5.68		5.60	
Total Other Long Term Liabilities (B)	97.22		92.56		90.17	
Total Gross Debt (A+B)	367.05		282.94		273.32	
Capital Financing Requirement*	705.70		670.61		645.58	
Less Other Long Term Liabilities	97.22		92.56		90.17	
Underlying Capital Borrowing Requirement (C)	608.49		578.05		555.41	
Under/(Over) Borrowing (C-A)	338.65		387.67		372.26	
Investments (D)	269.17	0.61%	255.92	0.56%	272.72	0.60%
Net Borrowing/(Investments) (A-D)	0.66		-65.54		-89.57	

* includes on balance sheet PFI schemes and finance leases

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

Borrowing Activity

Borrowing Activity for 1 April 2014 to 31 March 2015

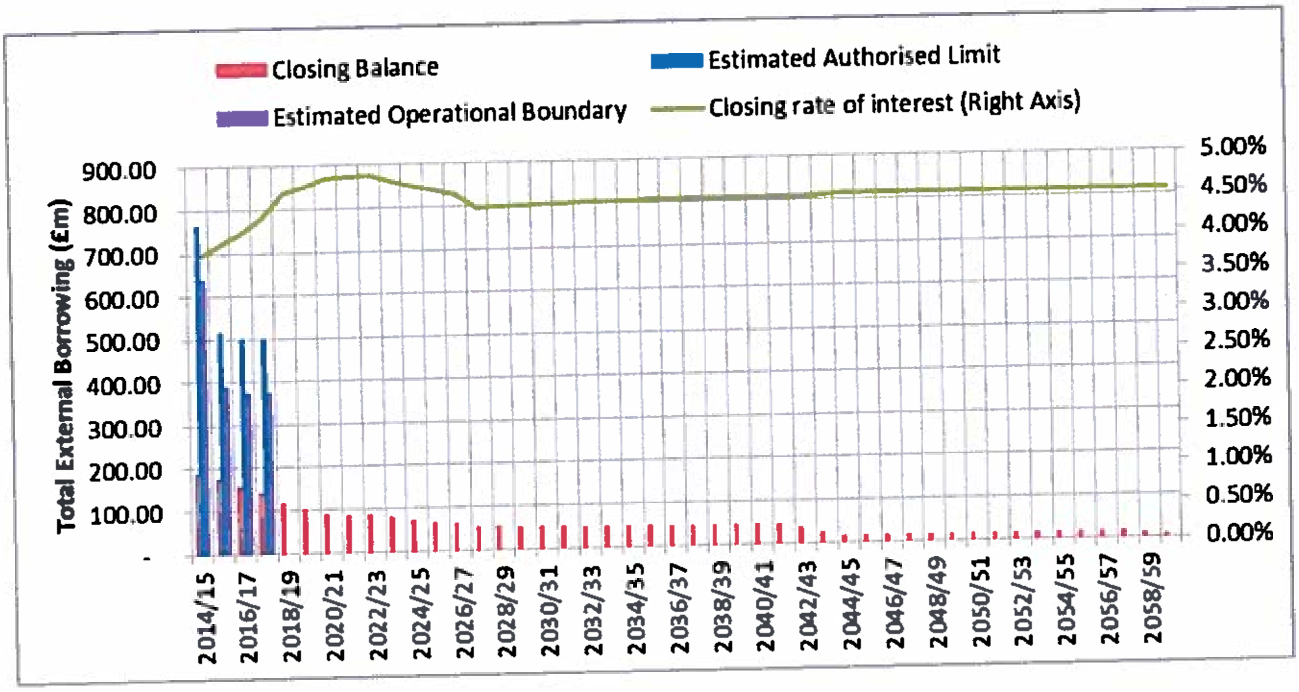
16 The 2014/15 TMSS did not include any new long term borrowing requirement and instead supported short term borrowing as a prudent option to cover any cash shortfalls. The Authority maintained an adequate cash balance throughout the year and therefore no new temporary loans were taken out during 2014/15.

17 Total borrowing of £79.46m was repaid in 2014-15. This included local authority temporary loans of £50m, PWLB loan principal of £19.46m and local authority long terms loans of £10m. At 31 March 2015 the outstanding debt portfolio balance was £190.38m. All outstanding loans in the portfolio are with the PWLB.

18 The cost of borrowing is shown at figure 1. The 2014/15 expenditure budget for interest on debt was £9.02m against an outturn of £7.79m, meaning a saving of £1.23m was made. The weighted average of the Authority's debt portfolio at 31 March 2015 was 3.84%. All loans within the portfolio are fixed rate.

19 The debt maturity profile of the portfolio is illustrated below and includes the key affordability indicators, the estimated Operational Boundary and Authorised Limit for 2014/15 through to 2017/18. Figure 1 also shows how the average rate will evolve as individual loans mature.

Figure 1 – Maturity profile of existing borrowing showing weighted average rate of interest



20 The Operational Boundary is set with reference to MOPAC's Capital Financing Requirement (CFR). The fact that at 31 March 2015, the Operational Boundary for borrowing is some £449m higher than the borrowing portfolio indicates the Authority is internally borrowing, i.e. utilising reserves and other cash balances in lieu of external borrowing.

Borrowing Activity for 1 April 2015 to 30 September 2015

21 As in 2014/15, no new long term borrowing was taken out. Loan repayments have reduced the total borrowing from £190.38m at the start of the year to £183.15m as at the 30 September 2015.

Investment Activity

Investment Activity and Governance

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

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

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

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

26 At no time does the GIS Investment Strategy conflict with the Authority's Treasury Management Strategy Statement (TMSS).

27 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 Activity and Performance

28 The Authority has outperformed its investment benchmark by 0.03% during 2014/15 and in the first half of the financial year to 30 September 2015 by 0.15%. For 2014/15, it achieved a cumulative weighted average yield of 0.46% on daily balances against an average 3 month LIBID of 0.43%. For the first half of the financial year to 30 September 2015, it achieved a cumulative weighted average yield of 0.60% on its daily balances against an average 3 month LIBID of 0.45%. Throughout the period, 1 April 2014 to the 30 September 2015, the Authority maintained its liquidity target of a weighted average maturity (WAM) of not more than 3 months. The cumulative weighted average yield of 0.60% is forecast to increase to 0.64%, as at the end of 2015/16.

29 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.

30 Investment performance therefore reflects the success of the decision to place investments in-house through the GLA GIS, which became fully operational in mid-2013.

- Methods used by the Group Treasury team in recent months to manage performance have included:

- Using the strength of the GIS's £2.4bn investment balances to obtain higher than average rates without increasing risk

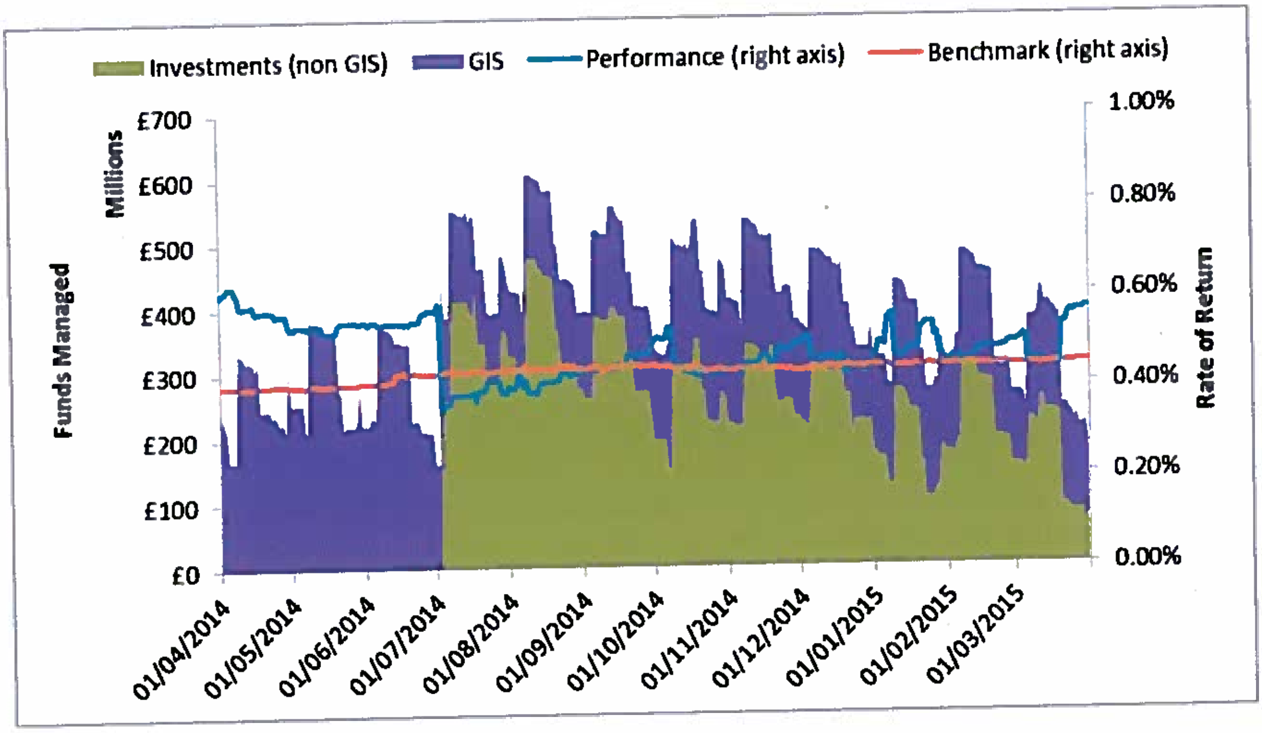
- Creating a well-diversified portfolio by country, by counterparty and by credit rating. In particular, counterparty diversification has increased, as a result of moving some balances away from Lloyds Bank, following the loss of its quasi-government status on the 15th May 2015, as a result of the Government's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

- 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.

- Monitoring market activity and proactively seizing investment opportunities

31 Figure 2 below shows the composition of investments (left hand axis) over the period and the Authority's average investment return performance (blue line) versus a benchmark of 3 month LIBID (orange line) measured on a percentage basis (right hand axis).

Figure 2 – Investment composition and cumulative annualised performance 2014/15



32 Following the implementation of the Authority's 2014/15 TMSS on 3rd July 2014, which enforced fixed exposure limits with individual counterparties, the Authority has also invested funds outside of the GIS, where exposure limits would have been exceeded if the full investment balance was held in the GIS. Whilst this new strategy allowed for essentially identical investment counterparties and

instruments, a significant difference is fixed exposure limits for individual counterparties, rather than limits that vary in proportion to forward looking average balances, as adopted by the rest of the parrticipating Group. The Authority's balances have been such that the pro rata share of GIS investments would have breached these fixed limits; accordingly, the GLA Group Treasury team was obliged to withdraw some of the Authority's monies from the GIS and invest in lower yielding instruments such as treasury bills. The resulting decrease in performance is reflected in Figure 2 above. With effect from July 2014, there was a sharp fall in performance, with pre July 2014 performance levels only properly returning when the Authority returned to full adoption of the GIS Investment Strategy at the start of the 2015/16 financial year.

33 From the 27th June 2014, Capita changed its credit worthiness methodology, so that it no longer considered viability, financial strength and support ratings as key criteria in the choice of credit worthy investment counterparties. This change was in response to the main rating agencies indicating that they are intending to remove implied sovereign support levels, which were introduced in response to the financial crisis of 2008, but are now no longer considered necessary, given the evolving regulatory environment. Whilst this now means the credit element of the Capita Asset Services methodology will focus solely on the Short and Long Term ratings of an institution, the Rating Watch and Outlook information will continue to be used where it relates to these categories and Credit Default Swap (CDS) process will continue to be utilised as an overlay to ratings. As a result, counterparties will no longer be penalised for weaker viability/support ratings or missing rates. Creditworthiness changes will, however, continue to arise from i) changes in CDS prices in the overlay to ratings or ii) changes in credit ratings.

34 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 invetsment 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 Governmnets to 'bail-in' by depositers. The impact has been three-fold:

- 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.

- 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.

- 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

	2014-15 Opening Estimate £m	2014-15 Year End Actual £m	Variance between Opening Estimate and Year end Actual £m	2015-16 Opening Estimate £m	2015-16 Actual as at 30.9.15 £m	2015-16 Revised Estimate £m	Variance between Opening Estimate and Revised Estimate £m
PWLB Interest payable	9.02	7.79	-1.23	7.22	3.65	7.22	0.00
Interest receivable	-0.80	-1.76	-0.96	-0.80	-0.97	-1.91	-1.11
Minimum Revenue Provision	31.48	30.28	-1.20	28.50	28.50	28.50	0.00
Total	40.50	36.31	-4.19	34.92	31.17	33.82	-1.11

35 Interest payable is reducing as the loan portfolio reduces, while interest receivable is holding up well in a low interest rate environment.

CIPFA Prudential Code Indicators and Treasury Management Limits

Background

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

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

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

a. Capital expenditure plans

b. External debt

c. Treasury Management

39 To ensure compliance with the Code in relation to the above elements, the Authority is required to set and monitor a number of Prudential Indicators. The setting of these Prudential Indicators is a circular rather than a linear process. For example, the level of external debt will follow on from the Authority's capital plans, revenue forecast and treasury management strategy. However, if initial estimates would

result in outcomes that would not be affordable or prudent, then plans for capital and/or revenue are reconsidered.

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

Capital Expenditure

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

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

Capital Expenditure

	2014-15 Original Estimate £m	Revised Approved Programme as at November 2014	2014-15 Year End Actual £m	2014-15 Variance between Revised Estimate and Year End Actual £m	2015-16 Original Estimate £m	2015-16 Actual As At 30.09.15 £m	2015-16 Revised Estimate £m	2015-16 Variance between Original Estimate and Revised Estimate £m
Capital Expenditure	368.16	227.00	199.36	-27.64	248.70	97.90	246.00	-2.70

43 The capital expenditure for 2014/15, at £199.36m, was £27.64m less than expected at the start of the year.

44 Capital expenditure for 2015-16 is expected to be £246.00m as at the 31 March 2016

Capital Financing Requirement

45 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.

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

47 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.

48 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.

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

Capital Financing Requirement (CFR)

	2014-15 Original Estimate £m	2014-15 Year End Actual £m	2014-15 Variance between Original Estimate and Year End Actual £m	2015-16 Original Estimate £m	2015-16 Actual As At 30.09.15 £m	2015-16 Revised Estimate £m	2015-16 Variance between Original Estimate and Revised Estimate £m
Total CFR	815.53	670.61	-144.92	645.58	638.55	645.58	0.00

50 The capital financing requirement is reducing over time.

External Debt Prudential Indicators

Authorised Limit for External Debt

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

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

53 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

	2014-15 Final Authorised Limit £m	2014-15 Actual External Debt £m	Headroom £m	2015-16 Original Authorised Limit £m	2015-16 Actual External Debt As At 30.09.15 £m	Headroom £m	2015-16 Revised Authorised Limit £m
Borrowing	764.20	190.38	573.82	515.50	183.15	332.35	515.5
Other long term liabilities	104.10	92.56	11.54	87.80	90.17	-2.37	87.8
Total	868.30	282.94	585.36	603.30	273.32	329.98	603.30

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

Operational Boundary for External Debt

55 The operational boundary is based on the same estimates as the authorised limit. However, it reflects an estimate of the most likely prudent but not 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.

56 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

	2014-15 Final Operational Boundary £m	2014-15 Actual External Debt £m	Headroom £m	2015-16 Original Operational Boundary £m	2015-16 Actual External Debt As At 30.09.15 £m	Headroom £m	2015-16 Revised Operational Boundary £m
Borrowing	639.20	190.38	448.82	390.50	183.15	207.35	390.50
Other long term liabilities	104.10	92.56	11.54	87.80	90.17	-2.37	87.80
Total	743.30	282.94	460.36	478.30	273.32	204.98	478.30

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

Gross Debt and the Capital Financing Requirement

58 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.

59 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) as at 31.03.15

2014-15 Actual Gross Debt As At 31.03.15 £m	Preceding Year CFR £m	2014-15 Additional CFR £m	2015-16 Estimated Additional CFR £m	2016-17 Estimated Additional CFR £m	Total CFR over 4 years £m	Amount Gross Debt < Total CFR over 4 years £m
282.94	705.70	0.00	0.00	0.00	705.70	422.76

60 Gross debt, as at 31 March 2015, is £422.76m 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.

Gross Debt and the Capital Financing Requirement (CFR) as at 30.09.15

2015-16 Actual Gross Debt As At 30.09.15 £m	Preceding Year CFR £m	2015-16 Estimated 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
273.32	670.61	0.00	0.00	0.00	670.61	397.29

61 Gross debt, as at 30 September 2015 is £397.29m 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

62 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.

63 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 2014-15

	2014-15 Opening Estimate %	2014-15 Year End Actual %	Variance between Opening Estimate and Year End Actual %
Financing Costs to Net Revenue Stream	2.30	2.35	0.05

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

Financing Costs to Net Revenue Stream 2015-16

	2015-16 Opening Estimate %	2015-16 Revised Estimate %	Variance between Opening Estimate and Revised Estimate %
Financing Costs to Net Revenue Stream	2.00	2.07	0.07

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

Incremental Impact of Capital Investment Decisions on the Council Tax

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

67 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

2014-15 Opening Estimate £	2014-15 Year End Actual £	2014-15 Variance between Opening Estimate and Year End Actual £m
0.23	-2.40	-2.63

68 The Authority has reduced the burden on the Council Tax payer.

Treasury Management Prudential Indicator

69 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.

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

Treasury Management Limits on Activity

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

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

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

Divided by

Total Borrowing less Total Investments

Fixed rate calculation:

(Fixed rate borrowing* less Fixed rate investments*)
Total Borrowing less Total Investments

*Defined as greater than 1 year to run to maturity

Variable rate calculation:

(Variable rate borrowing** less Variable rate investments**)
Total Borrowing less Total Investments

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

Upper limit on interest rate exposure on net principal sum outstanding on borrowing

	Opening 2014-15	As at 31.03.15	Opening 2015-16	As at 30.09.15
	%	%	%	%
Fixed rate	100.00	-290.46	150.00	-204.49
Variable rate	50.00	18.57	50.00	-304.49

72 To achieve certainty over its borrowing costs the Authority has locked into fixed rate loans. Investments are held at variable rates. The negative percentages reflects the net investment position of the Authority (rather than a net borrowing position)

Limits for Maturity Structure of Borrowing

73 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. The 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 each maturity period an upper and lower limit is set.

Limits for Maturity Structure of Borrowing for 2014-15

	Upper Limit	Lower Limit	As at 31.03.15
	%	%	%
Under 12 months	20.00	0.00	7.59
12 months and within 24 months	25.00	0.00	8.64
24 months and within 5 years	40.00	0.00	29.69
5 years and within 10 years	50.00	0.00	15.76
10 years and above	100.00	0.00	38.32

74 The Authority has a risk appropriate dispersion of debt over the years as shown in the table above.

Limits for Maturity Structure of Borrowing for 2015-16

	Upper Limit	Lower Limit	As at 30.09.15
	%	%	%
Under 12 months	100.00	0.00	8.99
12 months and within 24 months	100.00	0.00	8.99
24 months and within 5 years	100.00	0.00	32.81
5 years and within 10 years	100.00	0.00	9.83
10 years and above	100.00	0.00	39.39

75 The Authority has a risk appropriate dispersion of debt over the years as shown in the table above.

Limits for Principal Sums Invested for Periods Longer than 364 days

76 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

77 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.

78 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.

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

- 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 Treasury Management Strategy.

- 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.

80 The tables below show the full year 2014/15 and the half year 2015/16 investment portfolio of investments maturing after 364 days.

Long Term Cash Investments
as part of pooled monies within the GIS taken between 01/04/14 and 31/03/15

Date of Deal	Counter Party	£m	Interest Rate %	Maturity Date
20.05.14	Overseas Chinese Banking Corporation Ltd	5.02	0.90	20-May-15
06.08.14	The Royal Bank of Scotland Plc	3.35	1.07	6-Aug-15
01.10.14	Cooperatieve Centrale Raiffeisen Boerenleenbank BA	1.67	0.94	01-Oct-15
Total		10.04		

Long Term Cash Investments
as part of pooled monies within the GIS taken between 01/04/15 and 30/09/15

Date of Deal	Counter Party	£m	Interest Rate %	Maturity Date
20.05.15	Overseas Chinese Banking Corporation Ltd	9.02	0.90	20-May-16
Total		9.02		

New Long Term Borrowing taken between 01/04/14 and 30/09/15

81. 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.

82 No new borrowing was taken out during 2014/15 and for the first six months to 30 September 2015.

Financial comments

83 Financial implications are integral to the report and further comment is not required.

Legal comments

84 Part 1of the Local Government Act 2003 introduced a new statutory regime to regulate the borrowing and capital expenditure of local authorities. Section 23(1)(d) and (e) provides that the Greater London Authority (GLA) and the functional bodies (which includes MOPAC) are local authorities for this purpose.

85 Section 3(1) of the 2003 Act provides that all local authorities are to determine and keep under review how much money they can borrow. Section 3(2) of the Act is more specific in relation to the Mayor and functional bodies by providing that the determination is to be made by the Mayor following consultation with the Assembly, in the case of the GLA, or the relevant functional body. As a result, borrowing limits could be changed in-year, as well as at the start of financial years. Under section 1 of that Act the GLA and the functional bodies may borrow money for any purpose relevant to their functions under any enactment or for the purposes of the prudent management of their financial affairs; they may also invest for the same purposes under section 12.

86 Under section 127 of the Greater London Authority Act 1999 the Authority and functional bodies have a duty to make arrangements for the proper administration of their affairs. Responsibility for the administration of those affairs lies with the Director of Police Resources and Performance as the statutory chief finance officer of the functional body under section 127(2)(b) of the Act. The management of the Authority's Treasury function and the development and monitoring of the Treasury strategy fall within this responsibility of the chief finance officer.

Equality Comments

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

Supporting papers:

DMPCD 2014-031 - Treasury Management Strategy Statement 2014/15
DMPCD 2015-039 - Treasury Management Strategy Statement 2015/16