Subject: Group Treasury Management Arrangements

Report to: GLA Oversight Committee	
Report of: Chief Officer and Executive Director of Resources	**Date: 3 September 2019**
This report will be considered in public	

1. Summary

1.1 The paper presents an overview of the evolution and success of the Group Treasury shared service and the opportunity for further expansion to other public bodies, most significantly, the London Boroughs.

1.2 The role of the Greater London Authority's ('GLA') investment management company, London Treasury Limited is described and arrangements for the ongoing scrutiny of the Group Treasury function are set out.

1.3 This paper proposes a further stage in the process of ensuring that the GLA has the capacity and expertise to meet the increasing demands placed on its Group Treasury function, recognising the significant developments in the period since the last restructure of financial operations in February 2018.

1.4 The proposals are fully funded and involve no budget growth for the GLA. There is proposed net growth of one full-time equivalent post – (1.0 Full-time equivalent (**'**FTE**'**)), subject to one or more London Boroughs formally joining the function and an increase in the Chief Investment Officer's working hours of 0.2 of an FTE.

2. Recommendations

The Committee is recommended to:

2.1 **Note the background to the work of the Group Treasury team.**

2.2 **Respond to the Head of Paid Service's consultation in respect of the following proposals:**

(a) The deletion of the following 3 posts in the Group Treasury team (all 1.0 Full-time equivalent):

- **1x Grade 10 Senior Group Treasury Officer – Operations; and**
- **2x Grade 8 Group Treasury Officers.**

(b) The creation of the following 4 posts in the Group Treasury team (all 1.0 Full-time equivalent):

- **1x Grade 11 Treasury Operations Manager; and**
- **3 x Grade 10 Senior Group Treasury Officers (one of which will only be recruited to once one or more London Boroughs commit to join the Greater London Authority's treasury function).**

(c) An increase in the Chief Investment Officer working hours from 0.4 of a Full-time equivalent to 0.6 of a Full-time equivalent.

3. Background

3.1 The Group Treasury Team is responsible for advising on and managing the investments and borrowings of the GLA and its shared service partners. The team also supports the Chief Investment Officer, Assistant Director – Group Finance and Executive Director of Resources in the analysis and appraisal of major capital spending and investment decisions ranging from Housing and Regeneration (including the Interest Rate Setting Board and GLA Land Fund) to major infrastructure projects such as Crossrail and the Northern Line Extension.

Structure of the Treasury Management Function and Shared Service

3.2 The London Fire Commissioner (then the London Fire and Emergency Planning Authority ('LFEPA')) joined the GLA's shared service in 2011, with the London Legacy Development Corporation ('LLDC'), the Mayor's Office for Policing And Crime ('MOPAC') and the London Pensions Fund Authority ('LPFA') joining in 2013.

3.3 The combined cash balances of the participating group of Authorities (£3.6bn at time of writing), together with turnover arising from each participant's liquidity needs mean that the Group Treasury team are responsible for making investments of some £16bn in aggregate value annually. Alongside this, the team manages some £5.3bn of participants' long-term borrowing.

3.4 The GLA and other participants each develop a Treasury Management Strategy Statement ("TMSS") on an annual basis which:

- Sets out the framework for ensuring each organisation has liquidity to meet its operational cash flow needs; and

- Ensures that any surplus cash is invested in a manner which prudently balances the need to preserve capital against the opportunity to obtain a return on taxpayers' money to support services and offset the negative impact of inflation on the real spending power of that capital.

The TMSS also specifies Treasury Management Practices ("TMPs") to describe the control framework for how the Group Treasury team operates investment and borrowing on the relevant participant's behalf.

3.5 The shared service participants have a group contract with an independent advisory firm, Link Asset Services ("Link"), to provide independent review of individual borrowing and investment strategies and the performance and effectiveness of the Group Treasury team.

3.6 Following an internal review in 2018, including an independent report commissioned from Link, various measures have been taken to more appropriately resource the treasury function regarding its increased role and responsibilities. For instance, in order to achieve separation of duties, the Group Treasury team is supported by a Treasury Accountant within Financial Services and an external Custodian, State Street Global Services, who settle, hold and value the GLA's investments and are in the process of taking over the reporting of the shared service investment portfolios' compliance with their investment respective strategies.

3.7 The GLA has also established a wholly-owned subsidiary, London Treasury Limited ('LTL') to conduct the investment decision making and advisory aspects of the Group Treasury team's work within an environment that is authorised and regulated by the Financial Conduct Authority, thereby demonstrating market standards of professionalism, competence and individual accountability. This is described in further detail from paragraph 3.36 onwards.

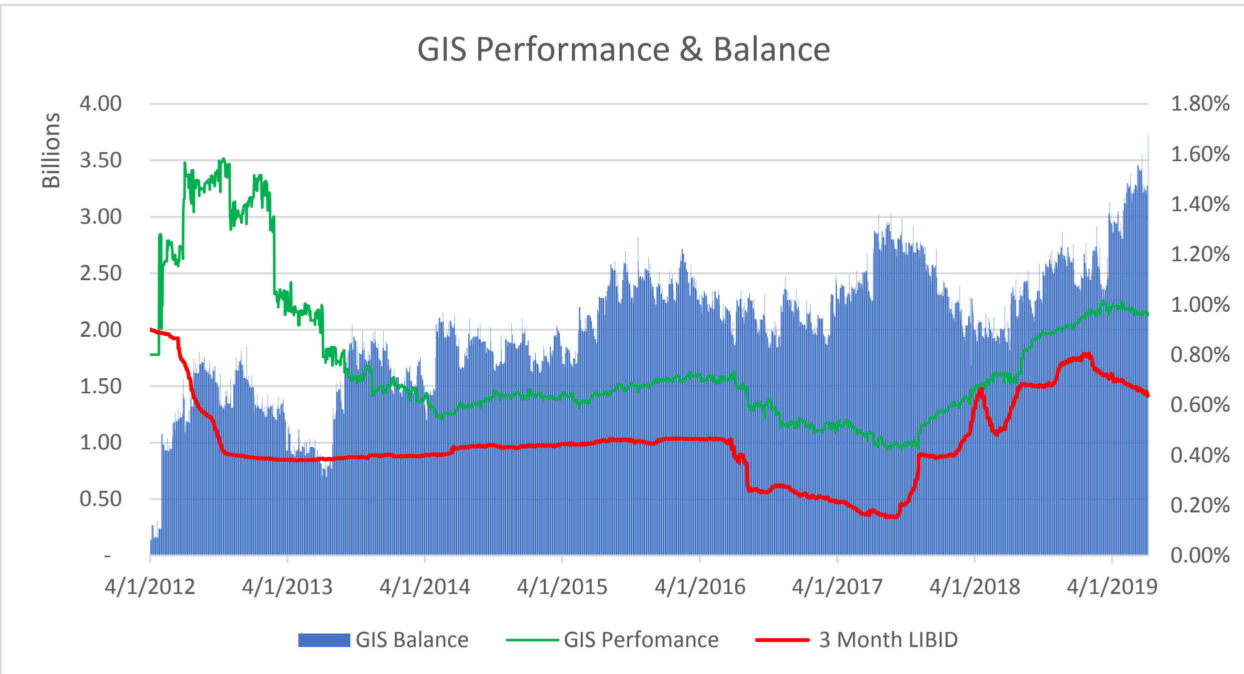
3.8 By pooling staffing and other administrative resources, the participants have been able to maintain or reduce individual expenditure on treasury management while funding a function able to operate more sophisticated strategies than might be feasible individually.

Investment Outcomes

3.9 A central part of this shared service arrangement was the establishment of the GLA Group Investment Syndicate ("GIS") as a means of pooling investments to achieve economies of scale and improved outcomes. The GIS participants have arrived at a common risk appetite for short term funds which is captured by the GIS Investment Strategy. Participants may also ask the Group Treasury team to invest longer term core balances outside the GIS according to their individual organisational risk appetites and requirements.

3.10 The pooled balance of the GIS is generally more stable than an individual participant's: since each participating organisation's cash flow profiles are unique, with individual ups and downs offsetting each other when combined. This means that the GIS has more scope to invest for longer periods than the participants might be able to if acting individually.

3.11 Balancing the need to offer a daily source of funds to participants against that opportunity, the GIS blends substantial overnight liquidity with some medium-term investments to improve overall returns, subject to a weighted average maturity limit of three months. Performance is therefore assessed against the London interbank bid rate for Sterling deposits over three months, "3M LIBID". GIS performance relative to this benchmark, as well as the daily balance since 2012 is set out below:



3.12 As shown, the GIS has outperformed consistently due to an agile investment approach, together with the benefits of scale. For example, the pooled GIS balances allow larger individual deals to be struck. The benefits of this are threefold –

- one transaction is made rather than a series of individual ones (saving costs);
- the larger transaction means better rates can be negotiated; and
- greater opportunities for diversification arise, since several banks in particular operate minimum deal sizes, which would be too high for individual participating organisations.

The latter point has helped to ensure that the GIS has remained well-within its aggregate credit risk limit, which is set with reference to the risk posed by a one-year deposit with an AA- rated bank.

3.13 Over the period 01 April 2012 – 30 June 2019 the GIS has contributed £108m to the finances of the GLA and its partners, with some 75% of this gain arising to the GLA and 25% to the other GIS members. Some £39m (36%) of this overall gain is attributable to outperformance against the benchmark, representing a material contribution to discretionary spending and far exceeding the function's costs.

3.14 Link, the independent advisor to the GIS participants, has provided a further comparator in the form of average net returns from commercial money market funds, a popular investment option for Local Authorities. Compared to this benchmark, GIS outperformance has been c.£49m.

3.15 In 2016 the GLA became the one of the first Local Authorities to invest directly into Senior UK Residential Mortgage Backed Securities ('RMBS'); UK and other European RMBS have little in common with the US instruments which achieved notoriety in the 2008 financial crisis, operating within a much tighter regulatory framework with far greater transparency. Stress tests indicate that for the instruments the GLA holds to lose money, over 50% of the underlying mortgage holders would need to default (the historical worst experience in the UK is 2%) and the value of the underlying properties must also fall by more than 50%. The Group Treasury team regard this as a considerably more remote prospect than an individual bank or insurer failing. Moreover, the instruments amortise quickly, providing liquidity without requiring sale before maturity.

3.16 Therefore, the strategy was pursued with risk reduction and diversification in mind, noting the GLA's concentrated exposure to the financial sector, reflecting concerns in advance of the Brexit referendum. As an additional benefit the GLA has been able to obtain superior risk-adjusted returns without compromising liquidity. Since inception, the strategy has contributed some £3m of outperformance, on top of what the GLA might have obtained through the GIS alone.

Borrowing Outcomes

3.17 The GLA, acting according to statutory best practice, only borrows what the Mayor and the Executive Director of Resources (as statutory chief financial officer) consider to be prudent, i.e. affordable and repayable over a period commensurate with the public benefit delivered by the borrowing-financed spending.

3.18 The Group Treasury team has delivered material success in debt management, supporting the GLA's contribution to major infrastructure projects and effecting a comprehensive restructure of debts inherited from the former London Development Agency.

3.19 Effective debt management is an essential priority for an organisation for which debt service represents some 50% of discretionary spending.

3.20 The GLA's comprehensive approach to managing borrowing risks, designed and delivered by the Group Treasury team, has enabled the GLA to maximise the amount of borrowing available for investment in statutory objectives, while remaining within the bounds of prudence. This is externally validated by the credit agency, S&P Global Ratings, which despite this high indebtedness, rates the GLA on a par with the UK Government. The GLA has only ever been downgraded as a result of its rating being capped at that of the UK.

3.21 As with the rest of Local Government, the GLA's default source of borrowing is the Public Works Loans Board ('PWLB') operating under HM Treasury. In 2010 the Government increased the PWLB's lending rates substantially. The £600m bond issued by the GLA in 2011 for Crossrail was delivered with pace and saved some £23m against the PWLB rates available at the time and moreover prompted a review of PWLB lending, leading to their rates being made available at levels closer to those achieved by the GLA's bond.

3.22 Developing capital and private markets expertise has reduced the GLA's dependence on central government for long term finance and created access to structures unavailable from the PWLB. In particular, the team has achieved considerable success in using alternatives to PWLB to manage the risks that interest rates and inflation pose to the affordability of the GLA's required borrowing.

3.23 To finance the Northern Line Extension ('NLE') and protect against future interest rate rises, a range of deals were negotiated with the European Investment Bank ('EIB') to fix interest rates in advance of drawing down loan proceeds. This saved a nominal £41m against market expectations of the equivalent future PWLB rates, and more crucially secured affordability. These loans have since been drawn down, and whilst actual interest rates have turned out to be lower than the market expectations at the time of the GLA's EIB deals, nevertheless an actual saving of £17m has been achieved.

3.24 Since retained business rates in the Nine Elms enterprise zone form a major part of the revenues that repay NLE borrowing over time, and those revenues are linked to inflation, the Group Treasury team recommended including some inflation linked borrowing in the overall financing package so that in the event of inflation being lower than forecast and revenues being reduced, financing costs would also fall. The team delivered this through the issue of a £200m bond linked to the Consumer Price Index ('CPI') in a landmark deal with a pensions insurance company at a very competitive rate. This award-winning transaction was the first CPI-linked bond ever issued in Sterling.

3.25 The combination of such significant borrowing and investment balances begs a question whether these balances should be offset to reduce net interest costs and investment risk, a practice known as 'internal borrowing' within local government. There are a number of factors to consider when evaluating such a decision:

- The GLA's strategic infrastructure investments are multi-decade in nature and borrowing is, in real terms, currently free (i.e. inflation erodes the value of the borrowing by more than current rates of interest); therefore, external borrowing at fixed rates to achieve certainty of cost is a sensible financing option on a self-contained project view;

- Current cash balances may persist, but this is uncertain, depending on a range of Government policies in respect of funding local services, in particular housing;

- If these funding arrangements change in future and the GLA's cash position deteriorates, external borrowing at the rates then in force will be required to fill the gap. It may be the case that interest rates remain close to current levels, but a reversion to historical averages would have an extremely significant adverse impact;

- Maintaining significant medium-term cash balances allows the GLA the flexibility to provide short or medium-term finance for regeneration programmes, such as that for the LLDC, and housing projects through the GLA Land Fund, or to achieve market-level or higher returns if this is not required;

- A strong liquidity position arising from high cash balances is a positive factor in credit rating agencies' assessments, so supports the maintenance of the GLA's rating; and

- The GLA's largest borrowing requirement arises from Crossrail and is repaid in large part by the Business Rates Supplement, the legislation around which necessitates a ringfenced account.

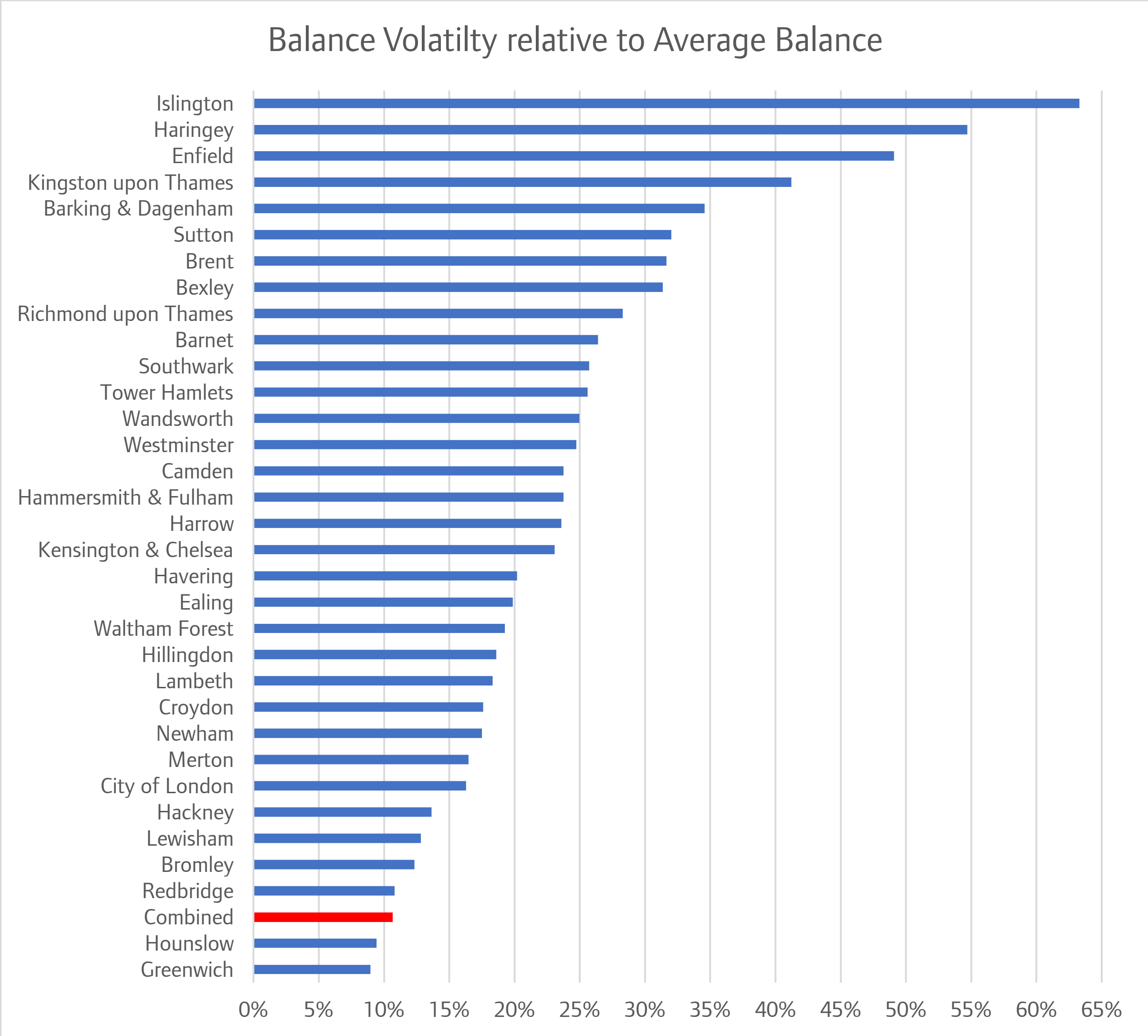
3.26 Balancing these factors, the GLA continues to finance major infrastructure on a stand-alone basis with identifiable pools of borrowing, subject to prudence and maintaining its credit rating. However, it will consider internal borrowing for new requirements that may arise.

Improving Returns on Long Term Balances

3.27 In the context of the above, the GLA has taken measures to increase the return on identifiable long-term reserves through the establishment of the London Strategic Reserve ('LSR') as described in MD2445 (Mayoral Decision - Treasury Management update and amendment to strategy statement). LSR seeks to achieve a return modestly in excess of inflation in order to protect the real spending power of public funds prudently held in reserve. Improved returns are achieved by sacrificing some liquidity and making investments that have levels of complexity and so require detailed due diligence from specialists, something that the GLA Group Treasury team can provide, but is often beyond the operational capability of less well-resourced functions. The GLA has seeded LSR with £300m, including the existing, high-performing RMBS portfolio, and is in the process of seeking co-investment from the London Boroughs.

Opportunities for Co-investment and Shared Service Expansion

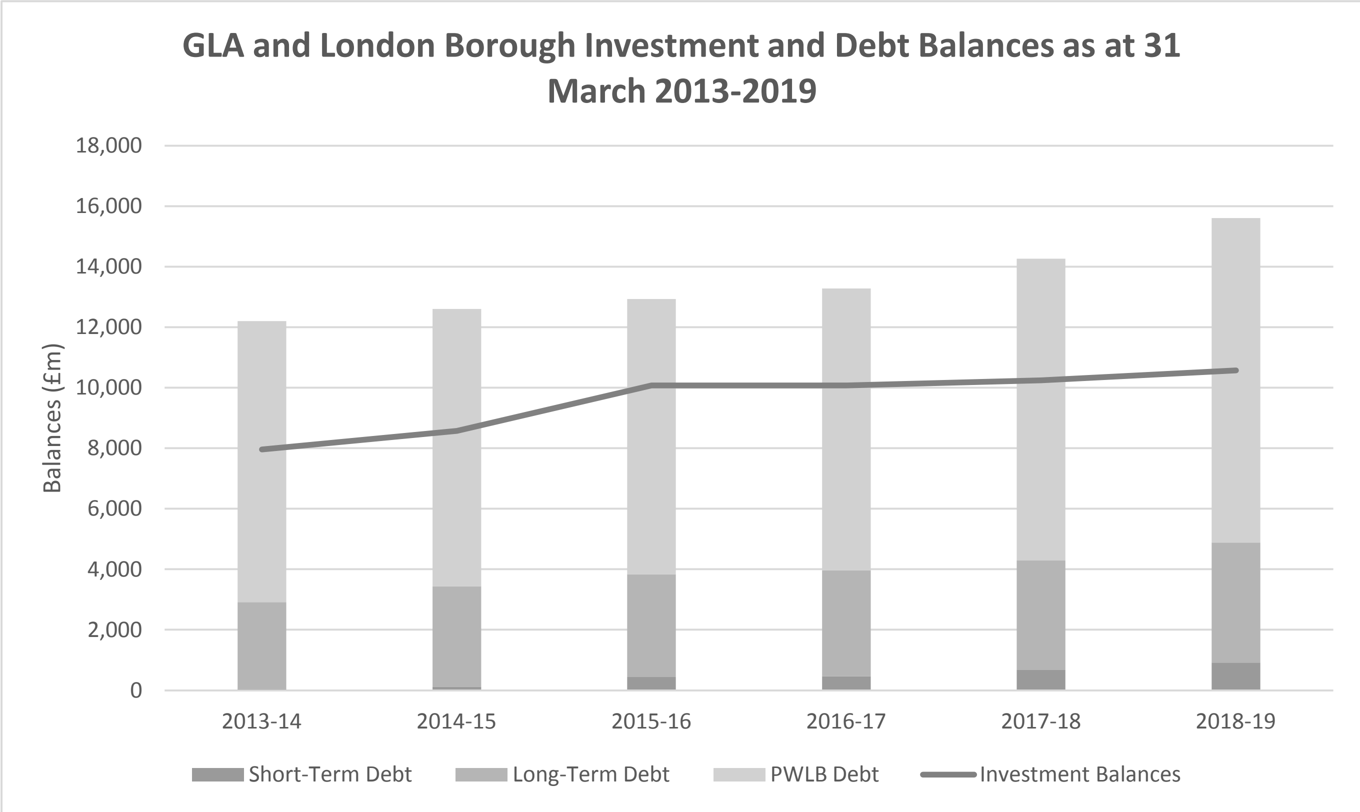
3.28 Collectively, London's aggregate Local Government cash balances have been much more stable than each authority on average. The chart below illustrates the monthly volatility of Borough balances relative to their average balances for the period June 2012 - July 2017, based on available MHCLG statistics. It shows that except for two marginal outliers, a pooled approach would provide much more stability for investment than could be achieved individually. Even for the outliers, the positive impact of investment scale is likely to more than adequately compensate any minor additional uncertainty.



3.29 Not every Authority needs all its core reserves at the same time, so by investing collectively there is an opportunity to invest more, for longer and so secure better returns to protect spending power without necessarily increasing risk to capital. Alternatively, or as part of this, there is an opportunity to offer intra-London borrowing at competitive rates.

3.30 Through LSR, the GLA seeks to offer one route to achieve these goals for those Boroughs that wish to participate. Moreover, it provides an opportunity for the GLA to add value to the wider public sector in London while potentially sharing the cost of operating a centre of excellence.

3.31 The Group Treasury team estimates that if just 20% of available balances were invested in this way, the annual increase in London's local spending power would be c.£60m. The chart below shows the scale of combined GLA and Borough treasury management balances, illustrating the scale of the opportunity:



3.32 It is hoped that participation in LSR may also be a gateway to wider treasury management shared service participation by some London Boroughs, further diluting the cost of providing a first-class service while increasing the scope for operational resilience through expansion of the team.

3.33 Where local circumstances make it a suitable option and both parties assent, the GLA believes the resilience and capabilities of the GLA shared treasury management service could be particularly advantageous for individual Boroughs whose local treasury resources may currently consist of one or fewer FTE posts.

3.34 The traditional link in local government between treasury and pensions means that the relevant staff are increasingly harder to recruit due to the reorganisation of the Local Government Pension Scheme ("LGPS"); the investment decisions at Local Authority level are increasingly outsourced to the emerging LGPS pools, who typically offer salaries more closely aligned with private-sector financial services and so compete for staff directly, while that same outsourcing of investment functions to the pools means that it is harder for new entrants to build the same levels of experience within local authorities.

3.35 The GLA therefore sees a potential opportunity to assist willing Boroughs in maintaining robust treasury management provision as local staff retire or move to other opportunities.

London Treasury Limited

3.36 Per MD2303 (Mayoral Decision - Acquisition of London Treasury Limited and related matters), the GLA acquired a Financial Conduct Authority ('FCA') authorised and regulated investment management subsidiary, LTL, in 2018 in order to:

- Facilitate the expansion of services to London Boroughs who, under the relevant legislation for shared services, cannot delegate investment functions to the GLA itself; and

- Assist in the professionalisation and separation of duties recommended by the GLA's independent treasury advisors.

3.37 LTL is an arms-length company governed by directors appointed by the Mayor and operating within a budget approved annually by the Executive Director of Resources. Day to day supervision is conducted by the Assistant Director – Group Finance. The current directors are Luke Webster (the GLA's Chief Investment Officer) and Ian Williams, the statutory chief financial officer for the London Borough of Hackney.

3.38 In addition to the budgetary control referred to above, LTL is bound by an investment management agreement with the GLA which tightly circumscribes its investment powers and prevents it from contracting with other clients without the GLA's consent.

3.39 LTL directly employs a compliance officer and an administrator in addition to the directors. It seconds members of the GLA Group Treasury team to deliver investment management and operations. The secondees continue to discharge GLA duties when not delivering investment-related functions.

3.40 The Chief Investment Officer remains employed by the GLA for 1 day per week in respect of borrowing decisions, representing GLA financial interests in Crossrail and other major programmes, such as Housing loans, and delivering general financial policy work and advice. His separately-contracted role at LTL is notionally equal to a further day per week, subject to the requirement to conduct all necessary actions to meet our regulatory obligations. In practice he works with the Assistant Director - Group Finance and Executive Director of Resources on combined priorities, with his combined remuneration set at an appropriate market level.

3.41 Alongside LTL's directors and compliance officer, secondees to LTL who exercise "Controlled Functions" are named on the FCA's Financial Services Register and held personally liable for their activities and for those of people under their supervision, subject to unlimited personal sanction from the FCA. The affected secondees are paid an honorarium by LTL in recognition of this responsibility and risk, reflecting the premium attached to being an Approved Person elsewhere in the market. Honoraria are set by the LTL Board within the budget approved by the Executive Director of Resources.

Scrutiny

3.42 Under prevailing statutory guidance, the Mayor is ultimately responsible for the Treasury Management Strategy of the GLA and related scrutiny. Given the materiality of interest payable and receivable to the GLA's budget and the potential consequence of errors, including loss of capital, consideration is being given to separately to enhancing the arrangements that support the Mayor in discharging this duty.

3.43 Following a recent internal audit review of the treasury function it is understood that the London Assembly considers that the Audit Panel is their most appropriate Committee to be nominated for the consideration of the scrutiny of treasury management, noting its terms of reference.

4. Issues for consideration – Restructure Proposal

4.1 The proposal recognises increased demands on the Group Treasury team arising from the report above, including:

- The continued growth in borrowing and investment balances across the Group Investment Syndicate;

- The need for increased operational resilience in the context of the scale of actual or opportunity cost of treasury management underperformance or error;

- Extra work involved in meeting the increased funding requirements for Crossrail;

- Establishing a centre of excellence to support collaborative working in London and the imminent prospect of one or more Boroughs joining the GLA's existing arrangements;

- Supporting a growing portfolio of investment activity in Housing and Regeneration;

- Requirements for more in-depth analysis and quarterly reporting on the GLA's exposure to financial risk to the new Financial Risk Oversight Board;

- Increased technical skills required for the effective delivery of LSR, requiring detailed research, analysis, selection and monitoring the investments that will form part of this fund; and

- The additional operational demands and personal liability placed on staff in the Group Treasury function as part of the establishment of LTL to widen the shared service offer and demonstrate meeting regulated market standards for investment management.

4.2 In addition to those factors, the GLA's implementation of Link's recommendations for further investment in compliance and systems has placed additional demands on the team for the negotiation and monitoring of complex external contracts with the relevant providers.

4.3 The report also noted the disparity between investment professionals' pay between the GLA and comparable sectors. The GLA has made considerable investment in training and developing the relevant staff and in consequence, the team has developed a strong track record as set out in this report. As LSR and previously existing operations continue to grow successfully, so will the commercial value of these staff's skill and experience, creating recruitment and retention challenges. The GLA will need to review this issue periodically, in the context of the financial value being added through the relevant activities and the risks arising were they not to be conducted appropriately. Meanwhile, it is proposed to create appropriately graded roles to reflect the growing professional demands and levels of responsibility attached to advising on and making borrowing and investment decisions at the current scale of operations.

4.4 It is therefore proposed to create three new Senior Group Treasury Officer (Grade 10) posts and to delete two Group Treasury Officer (Grade 8) posts. One of the new Grade 10 posts will only be recruited to on agreement from one or more London Boroughs to join the shared service or collective investment arrangements. Additionally, the Senior Group Treasury Officer – Operations (Grade 10) post will be deleted and replaced by a more senior Treasury Operations Manager (Grade 11). The existing and proposed structure charts are shown at Appendices 1 and 2 respectively.

4.5 The contracts for the new posts will include the requirement to carry out the parallel roles in LTL (set out in Appendix 3 under secondment or director's service contract as appropriate). The existing Chief Investment Officer and career grade Group Treasury Officers' contracts will also be amended to mirror this requirement.

4.6 The proposed new structure will provide the Chief Investment Officer with additional, higher-level, support in conducting investment appraisal and borrowing operations, enabling that postholder to provide additional strategic advice and support to existing shared service stakeholders while negotiating further arrangements for new joiners. The proposal also includes an increase in the Chief Investment Officer's total time commitment by 0.2 FTE, equally split between the GLA and LTL.

4.7 The restructure proposal is restricted to the Group Treasury function within the Group Finance unit. Other staff in the Group Finance unit and staff in the Finance & Governance unit are not affected by these proposals.

5. Consultation

5.1 In accordance with the GLA Head of Paid Service Staffing Protocol and Scheme of Delegation (the "Staffing Protocol"), formal consultation with the Chief of Staff (on behalf of the Mayor) and the Assembly's staffing committee, currently the GLA Oversight Committee, (on behalf of the Assembly) is required for this proposal as five or more posts within one unit are being created or deleted.

5.2 All finance staff in the Group Finance unit and Unison are also being consulted in accordance with the GLA Management of Change Procedure. The staff consultation runs from 14 August to 14 September. The Head of Paid Service ('HoPS') will take their views into consideration when making the decision.

6. Legal implications

6.1 Under the Greater London Authority Act 1999 (as amended), the HoPS may, after consultation with the Mayor and the Assembly and having regard to the resources available and priorities of the Authority:

- Appoint such staff as the HoPS considers necessary for the proper discharge of the functions of the Authority (section 67(2)); and

- Make such appointments on such terms and conditions as the HoPS thinks fit (section 70(2)).

6.2 The Assembly has delegated its powers of consultation on staffing matters to the Assembly's staffing committee, currently the GLA Oversight Committee.

6.3 After consultation with the Mayor and the Assembly, the Staffing Protocol was adopted by the HoPS in November 2009 and revised in July 2018. The Staffing Protocol sets out the Authority's agreed approach as to how the HoPS will discharge the staffing powers contained in sections 67(2) and 70(2) of the Greater London Authority Act 1999 (as amended).

6.4 Paragraph 5.1 of the Staffing Protocol says that, "The HoPS will consult the Chief of Staff, on behalf of the Mayor, and the Assembly's staffing committee, on behalf of the Assembly, on any major restructure; namely the creation or deletion of five or more posts within any one unit." As set out above, the Assembly's staffing committee is currently the GLA Oversight Committee.

6.5 The proposals set out in this paper fall within the definition of a 'major restructure' contained within the Staffing Protocol so require formal consultation with the Chief of Staff (on behalf of the Mayor) and the Assembly's staffing committee, currently the GLA Oversight Committee (on behalf of the Assembly), and the HoPS must take their views into consideration when making her decision.

6.6 The GLA should ensure that its Recruitment and Selection Policy and Equal Opportunities Standard are followed when recruiting to the vacant posts.

6.7 The GLA should follow its Management of Change Procedure in dealing with this restructure. If any employees are made redundant, the GLA's Compensation Payments Policy may apply.

7. Financial implications

7.1 The proposals involve additional annual costs to the GLA of £180,000 at 2019-20 salary levels. This will not involve any budget growth, though, as it will be met in full by proposed charges to London Boroughs joining the function and the marginal contribution from additional, more complex investment activity undertaken in the Team since February 2018 (£1.07m for 2018/19).

7.2 The importance of the treasury management function to the GLA's financial stability means that the maintenance and development of a suitably resourced team has significant benefit to the Authority's overall financial position.

8. Equalities implications

8.1 An Equalities Impact Assessment will be carried out to inform any decision to be made on this re-structure.

List of appendices to this report:

Appendix 1: Current Structure

Appendix 2: Proposed Structure

Appendix 3: LTL Structure (inclusive of GLA proposals)

Local Government (Access to Information) Act 1985

List of Background Papers:

None.

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