Item No: 8.3	Classification: Open	Date: 25 November 2015	Meeting Name: Council Assembly
Report title:		Treasury Management – Mid-year Update 2015/16	
Wards or groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATIONS

That council assembly:

1. Note the 2015/16 mid-year treasury management update.

2. Note the progress made in establishing the London Local Government Pension Scheme Collective Investment Vehicle (the CIV).

3. Note that the strategic director of finance and governance, after taking advice from the pensions advisory panel, will invest an estimated £150,000 in the CIV, which is required to meet the regulatory capital requirements needed for Financial Conduct Authority approval to operate.

4. Note that the strategic director of finance and governance, will enter into contractual arrangements with the CIV on behalf of the pension fund.

5. Note that the strategic director of finance and governance may, following consultation with the chair of the pensions advisory panel, take decisions to transfer pension fund assets to the CIV as set out in the report below.

BACKGROUND INFORMATION

6. This report is in two parts. The first part sets out the half-year treasury management update and covers debt outstanding from previous years capital expenditure, debt repayment, new debt to finance spend, prudent management of cash balances and related prudential indicators.

7. The second part advises on the London Local Government Pension Scheme Collective Investment Vehicle.

TREASURY MANAGEMENT – HALF YEAR UPDATE

8. Each year, the council assembly receives three reports on treasury management: a treasury strategy report before the start of the year, a mid-year update and an outturn report following the year end. That is the minimum number of reports to council assembly required under the constitution and also the number recommended by the Prudential Code for Capital Finance and the Treasury Management in the Public Services Codes of Practice and Guidance produced by the Chartered Institute of Public Finance and Accountancy (CIPFA).

9. The CIPFA codes recommendation for scrutiny and review of treasury

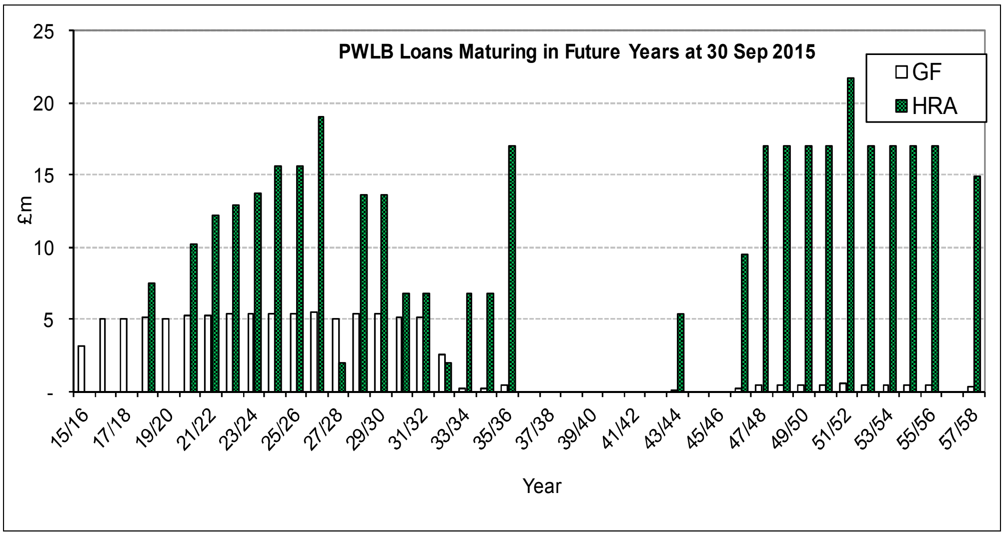
management is at Southwark carried out by the audit and governance committee. Quarterly updates are presented to cabinet and all executive and operational decisions are the responsibility of the strategic director of finance and governance.

KEY ISSUES FOR CONSIDERATION

Treasury management - debt

10. The balance remaining on past capital expenditure financed through loans as at 1 April 2015 was £469m (£371m HRA and £98m General Fund). All the loans are from the Public Works Loans Board (PWLB, part of HM Treasury). Over the half-year to 30 September 2015, £3.2m PWLB loans have matured.

11. The years in which the PWLB loans fall for repayment are set out in the chart below.



12. The average rate of interest on PWLB loans is currently running at 5.5% (6.0% HRA and 3.5% GF). As loans mature they are refinanced or paid off.

13. As well as PWLB loans, the council also has internal borrowing to support previous years' capital expenditure. The sum outstanding in internal borrowing at 1 April 2015 was £209m (£25m HRA and £184m General Fund). Internal borrowing is temporary drawing on internal balances pending replacement with loans. Both PWLB loans and internal borrowing are being is paid off. The General Fund debt is being paid off by way of the minimum revenue provision (MRP) in accordance with the council's MRP policy as required by government guidance. The MRP policy itself is discussed further below. The HRA is also prudently paying off debt, lowering the interest draw and raising the headroom for new investment.

14. The council's capital programme is expanding and this year, the HRA capital programme is expecting to draw on debt finance to secure investment in new housing, make existing properties warm dry and safe, and provide quality kitchens and bathrooms. Initially, up to £98m debt finance is being allocated to the programme. It would be available from 2015/16 onwards once the use of HRA reserves, capital receipts, grants and contributions is maximised. However it would not involve the council taking any new loans, but instead be advanced to the HRA by drawing on existing PWLB debt held by the General

Fund at an average rate of 3.5%, close to historical lows and well below the 6.0% rate on existing HRA loans. This ensures the council, as a whole, does not suffer a significant financial loss by borrowing money before it is actually needed.

15. The degree to which HRA can rely on debt finance to support its capital programme is constrained by its indebtedness cap. The cap was introduced by the government in 2012 as part of HRA self-financing and for Southwark was fixed at £577m, a level judged to be serviceable from council rents. The government at the time wanted housing authorities to support its priority of bringing public spending down and contain growth in public borrowing from rent income. Should the HRA draw on the whole £98m debt finance, its indebtedness would rise to £491m, which is well within the indebtedness cap.

Treasury management - investments

16. Cash that is not immediately used in spend is invested prudently until it is needed under an investment strategy agreed by council assembly in February 2015. Following an independent review last year by specialist investment advisors, investment flexibility within the strategy was improved by raising access to high rated supranational bonds, quasi-sovereign bonds, covered bonds and short term money market instruments issued by banks. The changes improve diversification and should help improve returns at the margin.

17. In the interest of security, bank exposure favours major high rated banks and liquidity is secured by using money market funds and short term money market securities. The strategy demands that no investment may be longer than five years and holdings beyond one year can only be in: government bonds, supranational bonds, quasi-sovereign bonds or covered bonds issued by major banks.

18. The strategy is executed with the help of two fund mangers (AllianceBernstein and Aberdeen Asset Managers) and in July 2015 the sum managed externally was raised by £50m. The managers now invest some £152m on behalf of the council in short term money markets and longer bonds within a risk controlled framework. The in-house operation manages day-to-day cash flow using money market funds and short term bank deposits. The council may draw down funds from the fund managers should cash be needed to meet spend.

19. The average cash balance held in investments over the first half of 2015/16 was £254m and the position at 30 September 2015 is set out in the table below. The half year return was 0.67%, reflecting the monetary stimulus still in place to support financial markets. Base rates in the UK have stood at 0.50% since 2009 and the market currently expects no rise before the 2nd quarter of 2016.

INVESTMENT COUNTERPARTY AND RATING AT 30 SEPTEMBER 2015							
TYPE	Country	Counterparty	Rating	Aberdeen	Alliance Bern	In-house	Total £m
GOV/SUPRA	CANADA	EXPORT DEVT CANADA	AAA	-	1.5	-	1.5
	GERMANY	FMS WERTMGT	AAA	-	3.8	-	3.8
		KFW	AAA	-	3.9	-	3.9
	NETHERLANDS	BNG-BANK NEDERLAND GEMENT	AA+	-	0.4	-	0.4
		NWB-NEDERLAND WATERBK	AAA	-	1.5	-	1.5
	SUPRANATIONAL	EUROPEAN INV BANK	AAA	7.0	5.0	-	12.0
		INT BANK RECONST DEVT	AAA	-	6.8	-	6.8
	UK	UK TREASURY	AA+	-	7.4	-	7.4
GOV/SUPRA Total				**7.0**	**30.3**	**-**	**37.3**
BANK COVRD	AUSTRALIA	ANZ BANKING CORP	AAA	-	2.3	-	2.3
		COMMONW BANK AUSTRALIA	AAA	-	1.5	-	1.5
		NATIONAL AUSTRALIA	AAA	3.5	1.0	-	4.5
	CANADA	BANK OF MONTREAL	AAA	-	1.5	-	1.5
		BANK OF NOVA SCOTIA	AAA	-	0.8	-	0.8
		CANADIAN IMP BK	AAA	-	1.5	-	1.5
		ROYAL BANK CANADA	AAA	3.5	2.3	-	5.8
		TORONTO DOMINION	AAA	-	1.5	-	1.5
	SWEDEN	SVENSKA STADSHYPOTEK	AAA	-	2.3	-	2.3
		SWEDBANK	AAA	-	1.5	-	1.5
	UK	BARCLAYS BANK	AAA	-	0.8	-	0.8
		LLOYDS BANK	AAA	-	1.5	-	1.5
		SANTANDER UK	AAA	-	2.3	-	2.3
BANK COVRD Total				**7.0**	**20.8**	**-**	**27.8**
BANK	AUSTRALIA	COMMONW BANK AUSTRALIA	AA-	-	-	10.0	10.0
	CANADA	TORONTO DOMINION	AA-	5.0	-	-	5.0
	DENMARK	DANSKE BANK	A	-	1.5	-	1.5
	FINLAND	NORDEA BANK FINLAND	AA-	7.2	1.0	-	8.2
	FRANCE	BANQUE NATIONAL DE PARIS	A+	0.4	3.5	10.0	13.9
		CREDIT INDUST ET COMRCL	A+	3.5	-	-	3.5
		SOCGEN	A	5.0	2.3	-	7.3
	GERMANY	DZ BANK	AA-	3.0	-	-	3.0
	GLOBAL	BLACKROCK MMF	Money Fund	-	-	19.0	19.0
		GOLDMAN SACHS MMF	Money Fund	-	-	20.1	20.1
	NETHERLANDS	ABN AMRO BANK	A	5.0	-	-	5.0
		ING BANK	A	3.5	3.5	10.0	17.0
		RABOBANK	AA-	-	2.0	-	2.0
	SWEDEN	SKANDINAVISKA	A+	-	2.0	-	2.0
	SWITZERLAND	CREDIT SUISSE	A	6.2	2.0	-	8.2
		UBS	A	3.2	2.3	10.0	15.5
	UK	BARCLAYS BANK	A	3.5	2.0	-	5.5
		HSBC	AA-	-	1.3	-	1.3
		LLOYDS BANK	A+	7.0	-	10.0	17.0
		NATIONWIDE BSOC	A	-	1.5	10.0	11.5
		STANDARD CHARTERED	AA-	6.0	-	-	6.0
	US	BNY MELLON	AA-	-	0.1	-	0.1
		CITIBANK	A+	3.5	-	-	3.5
BANK Total				**62.0**	**25.0**	**99.1**	**186.1**
Grand Total				**76.0**	**76.1**	**99.1**	**251.2**

Rating	**Definition**
AAA	Highest credit quality
AA	Very high credit quality
A	High credit quality
Ratings issued by Fitch or equivalent (The UK government and its treasury bonds are rated AA+ by Fitch, Aa1 by Moody's and AAA by Standard & Poor's) Money market funds have a AAA rating based on liquidity and diversification	

Prudential indicators

20. The CIPFA codes set out a series of prudential indicators to support local authority capital financing, borrowing and investment activities. The indicators were last approved by council assembly in February 2015. The 2014/15 outturn indicators were reported to council assembly in July 2015 and an update to 2015/16 indicators is set out at appendix A.

21. The indicators include a self imposed authorised limit on debt, determined under the Local Government Act 2003. As well as loans, the limit accommodates long term liabilities (e.g. from the three PFI funded schools and the integrated waste reprocessing facility), capacity to replace internal borrowing with loans and borrow for very short periods if needed for re-finance within a risk controlled framework. The 2015/16 authorised limit is £865m and the council has remained within it. Over the six months to 30 September 2015 the actual debt and PFI liabilities totalled £583m. The draw against the limit will increase where the council has to raise loans to prudently manage interest rate exposure or raise cash to meet spend.

Minimum revenue provision

22. Government guidance on the minimum revenue provision (MRP) requires that the General Fund set aside prudent sums to reduce debt arising from past capital spend. The 2015/16 MRP policy was approved by council assembly in February 2015. MRP cost falls on revenue budgets and runs on for many years into the future, usually over the period over which the expenditure provides benefits or the period over which the revenue grant supporting the expenditure runs for.

23. Government spending cuts are bearing down on local authority finances and challenging the sector's capacity to meets its MRP obligations. The council is therefore looking into how prudent MRP payments can continue, as they must do, and at the same time remain affordable. The council will not be able to change the total MRP it is liable for but may prudently adjust the timing of payments to improve affordability and manage with much lower funding. The review would look to secure changes to MRP that benefit 2017/18 when budget pressures from funding losses are expected to be most acute. It would at the same time take stock of any additional MRP arising from growth in capital expenditure financed from debt. Any changes to MRP would also be considered by the council's auditor.

BACKGROUND INFORMATION

Collective investment vehicle

24. The Local Government Pensions Scheme (LGPS) is distinct from other main public sector schemes in that it is funded. This means that contributions from employers and employees are placed in a fund that is then invested in assets such as stocks and shares, property and government bonds. A good return on investment is therefore crucial to the sustainability of the pension fund as any deficit is met from the council's revenue budget.

25. In London there are 33 pension schemes, administered by each London borough and by the City Corporation. Partly in response to the government's review in summer 2014 of the LGPS which considered opportunities for collaboration, cost savings and efficiencies, work has been under way to identify ways in which pension schemes can operate together so as to get financial benefits and economies of scale. One option identified is the establishment of a collective investment vehicle (CIV) and in February 2014 the London Councils Leaders' Committee agreed to recommend to all boroughs the establishment of a CIV. The strategic director of finance and governance, in consultation with the then cabinet member for finance, strategy and performance, agreed to commit £75,000 to the set up costs of the CIV. To date the council has paid £50,000 of this.

26. Participation in the CIV and agreement to become a shareholder, including a contribution of £1 as initial capital, was approved by the then cabinet member for finance, strategy and performance in September 2014. She noted the proposed formation of the London boroughs “Pension CIV Joint Committee”, a new representative body to be established for those local authorities agreeing to participate and also agreed to delegate to the strategic director of finance and governance authority to act for the council in exercising its rights as a shareholder. The report noted that in addition to set up costs, in order to achieve regulatory clearance from the Financial Conduct Authority (FCA) to enable it to trade, share capital which was then estimated at £100,000 would be needed.

27. Since then, a company, the London LGPS CIV Ltd, has been incorporated and a Pensions CIV Sectoral Joint Committee has been set up. This comprises elected members of participating local authorities whose role is to over see the CIV, including the consideration of appropriate governance arrangements, and to act as a platform for shareholder meetings and decision making. Further progress in 2015 is set out in the paragraphs below.

KEY ISSUES FOR CONSIDERATION

Collective investment vehicle

28. Progress made in 2015 in relation to the establishment of the CIV has been significant. Thirty one London boroughs have agreed to participate and the cabinet member for finance, modernisation and performance has attended the four meetings which have been held of the Pensions Joint Committee referred to in paragraph 27. Key matters considered have been:

- The establishment of the operating company (London LGPS CIV Ltd) and its governance arrangements
- The appointment of an asset servicer, Northern Trust, for the CIV. Its role is the provision of depositary, custodian, fund accountant, transfer agency and tax reclaims services
- Its role as a forum for shareholders in the CIV.

29. Interim directors of the CIV (London Councils’ Chair, Vice Chairs and chief executive, two borough treasurers, and the Chamberlain of the City of London) have met and considered or ratified decisions concerning:

- Procurement activity, including the recruitment of permanent executive and non-executive members of the board, and legal and technical advisers
- The appointment of Northern Trust as asset servicer
- The recruitment process for senior executives and future board members.

30. A technical sub-group has been set up and has considered:

- The process by which fund managers with whom boroughs currently invest might come on to the CIV
- The process of narrowing down those managers for the launch phase of the CIV and proposals put forward by those managers for reducing fees and for the scope of investment
- The initial structures and governance modeling of the CIV and methods

by which the borough will interact with it

- Procurements including the reviewing and ratification of candidate responses
- An initial paper on regulatory capital requirements to meet liquidity needs as set out by the FCA.

31. Although the government has not yet published its response to the 2014 LGPS review, working together through a CIV is in line with the reform proposals outlined in the consultation document.

32. Articles of association and a shareholders' agreement have been drafted and are scheduled to go to the Pensions Joint Committee's meeting on 23 September 2015 for final adoption, and in the case of the shareholders' agreement, signature.

33. Paragraph 26 above noted the requirement for regulatory capital, needed to satisfy the FCA that the company would be able to discharge its financial obligations in the event of failure. This is now estimated to be in the region of £150,000 for each participating borough and council assembly is asked to note the investment of this sum in the CIV by the strategic director of finance and governance, after taking advice from the pensions advisory panel.

34. Fund managers with multiple mandates across London have provided offers for fees for inclusion in the CIV and it is expected that boroughs which currently invest with those managers will be asked in the near future if they would wish to transfer existing funds with that manager to the CIV under the CIV fee schedule. Those boroughs that wish to do this will need to sign contracts and transfer funds once the FCA has cleared the CIV to operate. It is imperative that this can be done speedily to avoid the risk of delaying the launch of the CIV, thereby reducing the immediate benefits to the boroughs.

35. The council does currently invest with managers who, it is understood, have provided fees for inclusion in the CIV and the option of transferring funds to the CIV will therefore be available in the near future. In the event that, in the opinion of the strategic director of finance and governance, there are financial benefits from transferring funds to the CIV, he may, after taking account of the pension advisory panel's advice, take decisions to transfer pension fund assets to the CIV and enter into the appropriate contractual arrangements needed to achieve this. Again, in the event that action is required within tight timescales such that it is not possible to seek the panel's advice, the strategic director of finance and governance will consult with the chair of the panel.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

Treasury Management

36. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit and governance committee.

37. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a quarterly basis to cabinet and at mid and year-end to council assembly. Furthermore all

executive and operational decisions are delegated to the strategic director of finance and governance.

38. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

39. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) produced under amendments made to section 21(1A) of the 2003 Act by section 238(2) of the Local Government and the Public Involvement in Health Act 2007.

Collective investment vehicle

40. Section 1 of the Localism Act 2011 gives a local authority the power to do anything that individual of full capacity may generally do. Therefore, the council has power to participate in the establishment of the CIV and the incorporation of the authorised contractual scheme operator established for this purpose.

41. The report refers to the Pensions CIV Sectoral Joint Committee established under the recommendation of the London Councils Leader's Committee. This committee will act as the shareholder body for the authorised contractual scheme established for the purposes of the CIV, and it will act as a forum for the participating authorities to consider and provide guidance on the direction and performance of the CIV as an investment vehicle. It will exercise functions delegated to it by participating authorities, which is permissible under the Local Authorities (Arrangements for the Discharge of Functions) (England) Regulations 2012.

42. The council remains the administering authority for the Southwark LGPS and retains ultimate responsibility for the administration and governance of the scheme, in accordance with the Public Services Pensions Act 2013 ("the 2013 Act") and regulations made under it.

43. Functions relating to the CIV and investment decisions are executive functions exercised under the council's scheme of management by the strategic director of finance and governance, who will take into account the advice of the council's Pensions Advisory Panel, established in accordance with the 2013 Act. As such, council assembly is asked to note the current position.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Decision - Local Government Pension Scheme - London Collective Investment Vehicle (CIV) - Southwark Council	Constitutional team, 160 Tooley Street Address	Constitutional team 020 7525 7055

APPENDICES

No.	Title
Appendix A	Prudential Indicators 2015/16 Mid Year Update

AUDIT TRAIL

Lead Officer	Jennifer Seeley, Director of Finance	
Report Author	Fay Hammond, Department Finance Manager Corporate Finance	
Version	Final	
Version Date	11 November 2015	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	N/A	N/A
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		12 November 2015