

GREATER LONDON AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2616

Title: Investment Structures and Subsidiaries

Executive Summary:

Approval is sought to create investment fund structures that will facilitate co-investment from London boroughs and other third parties into the London Strategic Reserve (LSR) (established by MD2445) and the commercial strand of the Homes for Londoners Land Fund (established by MD2207). Approvals include ensuring that the relevant entities meet regulatory capital requirements.

Decision:

The Mayor:

- 1) approves the establishment of a new Scottish Limited Partnership (SLP) structure for the London Strategic Reserve (LSR) with the GLA becoming a limited partner in the SLP, with one or more London boroughs and potentially functional bodies as other limited partners;
- 2) approves the creation of an Arm's Length (for the purposes of 'Mayoral Decision Making in the GLA') company limited by shares and incorporated in Scotland as a new wholly owned subsidiary of London Treasury Limited (LTL) for the purpose of acting as the General Partner (GP) of the SLP for LSR with the governance arrangements set out in this decision form (including approval of the initial GP director appointments proposed, subject to them agreeing to terms and conditions of appointment);
- 3) approves the transfer of assets currently held in the name of the GLA in the existing LSR structure to the new SLP by way of the GLA's investment as a limited partner in the SLP;
- 4) approves the issue of new ordinary shares up to a value of £1m in LTL to its sole member Greater London Authority Holdings Limited (GLAH) as required to meet Financial Conduct Authority (FCA) or other legal or compliance requirements;
- 5) authorises the Executive Director of Resources to approve on behalf of the GLA any amendment to the LSR investment strategy (appended to MD2615) as may be required from time to time on the recommendation of the Chief Investment Officer;
- 6) authorises the Interim Deputy Executive Director for Housing and Land and the Chief Investment Officer to undertake market-testing and commission necessary advice to create a similar structure for the commercial strand of the Land Fund; and
- 7) authorises the Executive Director of Resources to do all such things (including the finalisation, approval and execution of any documents and agreements) that he may consider necessary or desirable to give effect to the decisions listed above.

Mayor of London

I confirm that I do not have any disclosable pecuniary interests in the proposed decision and take the decision in compliance with the Code of Conduct for elected Members of the Authority.

The above request has my approval.

Signature:



Date:

18/3/20

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

Decision required – supporting report

1. Introduction and background

Collective investments

- 1.1. The London Strategic Reserve (LSR) was established with the intention of being a pooled investment vehicle for the GLA and London boroughs' core reserves, created to deliver protection against inflation eroding the spending power of long-term balances (see MD2445). The commercial strand of the Land Fund (established by MD2207) seeks to attract likeminded investors alongside a GLA commitment of £250m to housing and regeneration related projects in order to maximise the total number of homes delivered. The current positions of LSR and the Land Fund together with their latest investment strategies are set out in the GLA's Treasury Management Strategy Statement, MD2615.
- 1.2. Although the GLA has operated a successful collective investment agreement, the Group Investment Syndicate (GIS) since 2011, this has been in the context of participating investors who are functional bodies or closely related entities subject to Mayoral influence and control, such as the London Pensions Fund Authority (LPFA). These arrangements have been contractual in nature, rather than a fund with a legal personality and have been outside the scope of any required authorisation by the Financial Services and Markets Act 2000 (FSMA) and/or regulation by the Financial Conduct Authority (FCA).
- 1.3. Unlike functional bodies and the LPFA, London boroughs are not subject to section 401A of the Greater London Authority Act 1999 which enables the delegation of administrative, technical and professional services (including investment management) to the GLA. Although London boroughs are not covered by section 401A, they and the GLA are local authorities for the purposes of the Local Authorities (Goods and Services) Act 1970. As a result, the GLA may provide the same professional, technical and administrative functions involved in treasury management to boroughs, who also share the same investment powers. However, the Local Authorities (Contracting Out of Investment Functions) Order 1996 requires that London boroughs may only contract investment functions to persons authorised under the FSMA. London Treasury Limited (LTL) was acquired for the purpose of expanding treasury shared services and co-investment to London boroughs via MD2303. LTL now manages the GIS on the GLA's behalf in advance of expected borough entry.
- 1.4. The issue of regulation applies separately to the investment arrangement (the fund) and the person managing it (the manager). Since LSR and the Land Fund are expected to have co-investors who are not engaged in shared services with the GLA for day to day cash management, it is likely LSR and the Land Fund will meet the criteria of Collective Investment Schemes within the terms of the FSMA. Therefore, both arrangements will be regulated.
- 1.5. The GLA and LTL have instructed external lawyers to advise on potential fund structures for LSR given the anticipated regulatory requirements. A Scottish Limited Partnership (SLP) has been determined to be the closest match to the goals of achieving flexibility for investors across the range of potential assets being considered by LTL, ensuring investment in LSR would not be treated as capital expenditure and avoiding excessive cost or introducing new tax complexity or liability.
- 1.6. The key distinction between SLPs and English Limited Partnerships is that SLPs have their own legal personality. This simplifies contracts involving the partnership. For LSR, this is a considerable advantage as it will frequently be investing in other funds, some of which are themselves partnerships. The structure is very common in fund-of-fund investments for this reason.
- 1.7. The Partnership will require a general partner (GP) which will have unlimited liability (which will be appropriately insured) for the SLP's activities and will be responsible for managing the partnership and its assets, or else appointing a manager. The investors, including the GLA, will be Limited Partners (LPs) with liability limited to any outstanding commitment to the partnership.

- 1.8. LSR will meet criteria for regulation as an Alternative Investment Fund (AIF) under the structure proposed. Any manager must have permissions as an Alternative Investment Fund Manager (AIFM); LTL is therefore varying its permissions to meet this standard.
- 1.9. The GLA's legal advice strongly recommends that the GP is registered in Scotland. It would be costly and time consuming to create a new regulated entity, therefore creating the GP as a subsidiary of LTL (a company registered in England and Wales) is recommended. The GP will then appoint LTL as the appropriately regulated manager. This structure (GP as a subsidiary of the manager) is commonly found in SLPs.

SLP governance

- 1.10. It is proposed that the Articles of Association of the GP will mirror those of LTL (see MD2303) other than in respect of number of directors and amount of share capital and any amendments as may be appropriate in relation to its status as a Scottish incorporated company and its purpose as a GP.
- 1.11. It is intended that the initial GP directors will be the same as the directors of LTL, ex-officio, and further directors may be appointed (or removed) by the LTL board with the consent of the Executive Director of Resources as shareholder representative to LTL, following consultation with the Chief of Staff. This will allow the involvement of borough stakeholders and/or independent non-executives in due course. Unlike LTL itself, the GP will not be regulated, so the directors will not need to be approved by the FCA, although LTL will consider equivalent fitness and propriety considerations prior to recommending any appointment.
- 1.12. The initial share capital of the GP will be determined by LTL following legal advice; allotment of shares to parties other than the founding shareholder (LTL) will be reserved to the Mayor but otherwise a matter for shareholders in the usual way for private companies.
- 1.13. The Limited Partnership Agreement (LPA) constituting the SLP will require that investment by the SLP is in accordance with the LSR investment strategy (approved by the Mayor) in force at foundation. The LSR investment strategy will only be alterable by majority LP consent, with a GLA veto as the principal founding investor.
- 1.14. LTL, as manager, will maintain an investment committee constituted as set out in MD2615.
- 1.15. The LPA will contain provisions for the establishment of a Limited Partners Advisory Committee (LPAC). The powers of the LPAC will be agreed between the Chief Investment Officer and the founding London borough partner(s).
- 1.16. Other matters of the LPA will be prepared by LTL's external lawyers, overseen by the LTL Board, in consultation with the GLA's legal team and with input from the other founding partner(s). The Executive Director of Resources will determine the LPA is consistent with the GLA's prevailing treasury management strategy statement (TMSS) prior to committing the GLA to becoming a LP.

Regulatory capital

- 1.17. Businesses regulated under the FSMA are required to report regulatory capital to the FCA to demonstrate appropriate financial resilience. The amount required depends on the permissions being exercised, the nature and size of funds under management and the turnover of the business. Ordinary share capital is the preferred source as the proceeds are unambiguously available to fund any company liabilities that may arise.
- 1.18. LTL's required variation of permissions is expected to lead to a higher requirement of regulatory capital, which will vary according to the investment portfolio size of LSR. It is not expected that additional regulatory capital requirements will exceed £1m.
- 1.19. LTL has raised share capital in the past to provide regulatory capital as set out in MD2365. As that decision sets out, LTL holds all the money in reserve so there are no net spending consequences.

There is a small opportunity cost to LTL's regulatory capital as it is invested in a lower risk way than the GIS or LSR, so achieves a lower return, however for the sums involved, this is immaterial.

- 1.20. Under LTL's Articles of Association, the issuance of new share capital requires Mayoral approval. Since LTL's permission to manage LSR is contingent on adequate capital and the GLA and partners would suffer disruption and potential loss if this permission were withdrawn, it is proposed that the Mayor approves new shares in LTL up to a value of £1m being issued to the existing shareholder, Greater London Authority Holdings Limited only, and for regulatory purposes only.
- 1.21. Group Treasury have ensured all LSR investments to date have been made with a right of transfer from the GLA to an entity of the GLA's specification. Following formation of the SLP, the GP will agree a transfer date with the LPs and LTL will arrange transfer of the assets of the GLA in the existing LSR structure into the partnership, recognising the value of assets as at the transfer date as a GLA investment into the SLP.

Land Fund structure

- 1.22. The structure above could also work to enable other parties to invest into the commercial strand of the Land Fund, noting a separate GP would be appropriate to ringfence any fund liability. Were the management of the relevant assets to continue 'in-house', suitably qualified Housing and Land Officers could be seconded to LTL to provide specialist real estate knowledge and LTL's permissions could be appropriately modified.
- 1.23. However, the GLA recognises that there may be potential partners or third-party managers with significant expertise and resources who may be better placed to manage the collective portfolio and that there may be advantages to appointing an established manager with a strong track record, including an increased perception of objectivity and a reduction in transactional risk for the GLA. This would not prejudice the GLA's ability to identify suitable projects and present them to the fund.
- 1.24. In particular, the GLA is in discussion with the LPFA, Local Pensions Partnership and London CIV in respect of their London Fund, to establish whether there is an opportunity to manage the property element of that fund together with the commercial strand of the Land Fund, thereby avoiding duplicated efforts. The GLA is also discussing potential collaboration with TfL.
- 1.25. This decision authorises the (Interim) Deputy Executive Director for Housing and Land and the Chief Investment Officer to enter into discussions with market participants and evaluate delivery options, including selecting a potential manager and commissioning necessary legal and investment advice to be funded from the Land Fund administrative budget, in order to present a final model for approval in early 2020/21.

2. Objectives and expected outcomes

- 2.1. Collective investment is an example of collaborative working and an opportunity for the GLA to maximise the public benefit of its resources.
- 2.2. By increasing assets under management, successful co-investment structures will enable the GLA to:
 - generate economies of scale in relation to investment costs;
 - achieve greater diversification to reduce risk;
 - obtain better terms from investment counterparties; and
 - reduce liquidity risk by pooling the balances of investors with different cash flow needs (deposits by some, offset by withdrawals from others).
- 2.3. These improved outcomes are expected to support the GLA's financial objective of ensuring the return achieved on the two longer-term LSR and Land Fund allocations of GLA balances exceed inflation, and preserves or increases real spending power.

- 2.4. In the case of the Land Fund, a greater level of overall investment should lead to a greater number of homes being delivered.

3. Equality comments

- 3.1. Under section 149 of the Equality Act 2010, as a public authority, the Mayor of London must have 'due regard' of the need to eliminate unlawful discrimination, harassment and victimisation as well as to advance equality of opportunity and foster good relations between people who have a protected characteristic and those who do not.
- 3.2. The "Equality comments" contained in MD2207 and MD2396 in respect of the Homes for Londoners Land Fund also apply to this decision.

4. Other considerations

- 4.1. There is widespread use of SLPs as private fund structures. The comparative simplicity, flexibility and affordability of SLPs has been exploited by some formation agents, with such structures being created and sold to investors or operators suspected of money laundering or similar impropriety, leading to enhanced regulatory and media scrutiny. The GLA and its prospective partners have a clear rationale for the use of this structure and all prospective LPs will be subject to due diligence, therefore reputational risk is mitigated.
- 4.2. The widespread, cross-border use of SLPs as a key part of the institutional investment landscape provides assurance that the risk of any jurisdictional area change will be managed by legislators and regulators.

Declarations of interest

- 4.3. The Chief Investment Officer is also director of LTL. Any conflict of interest is mitigated by the LTL's not-for-profit nature and the high level of transparency and control by the GLA of the LTL's remit and budget.

5. Financial comments

- 5.1. LTL's variation of required permissions is underway and is expected to be approved before July 2020. Subject to this decision, the other aspects of forming the GP and partnership will be pursued in parallel. These establishment costs are expected to remain below £100k and are funded from existing Group Treasury budgets (inclusive of payments to LTL). On formation, set up costs will be recovered pro-rata from the LPs. Ongoing running costs which will be funded from SLP investment income (or assets in the absence of such income), therefore also shared pro-rata between the LPs.
- 5.2. The Land Fund set up costs will be met from the £5m fund administration budget approved in MD2207.

6. Legal comments

Investment in LSR

- 6.1. Part 1 of 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 are local authorities for this purpose.
- 6.2. Under section 12 of that Act the GLA, functional bodies and London boroughs as local authorities may invest for the purposes of the prudent management of their financial affairs.

- 6.3. Under section 127 of the Greater London Authority Act 1999 (GLA Act) the Authority has a duty to make arrangements for the proper administration of its affairs. Responsibility for the administration of those affairs lies with the Executive Director of Resources as the statutory chief finance officer of the Authority 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 financial officer.
- 6.4. Section 401A(2) of the GLA Act, as amended, permits a shared service arrangement, by providing that any 'relevant London authority' (as defined in the GLA Act) may enter into arrangements for the provision of administrative, professional or technical services by any one or more of them to any one or more of them, whether for consideration or otherwise. This enables the GLA, the Functional Bodies and the LPFA to delegate the professional, technical and administrative functions involved in treasury management to the GLA and for them all to jointly participate in LSR under their common powers to invest for the prudential management of their financial affairs.
- 6.5. Although London boroughs are not covered by section 401A, they and the GLA are local authorities for the purposes of the Local Authorities (Goods and Services) Act 1970. As a result, the GLA may provide the same professional, technical and administrative functions involved in treasury management to boroughs, who also share the same investment and borrowing powers.
- 6.6. However, the Local Authorities (Contracting Out of Investment Functions) Order 1996 requires that Local Authorities may only contract with a Financial Services and Markets Act 2000 authorised firm in respect of certain investment functions. The GLA's authorised and regulated subsidiary, LTL, may provide those functions that the GLA itself may not. LTL will therefore manage investments into the GIS and LSR, including on behalf of the GLA and London boroughs.

Establishment of the GP and SLP

- 6.7. The GLA's principal purposes, under section 30 of the Greater London Authority Act 1999 (GLA Act), are to promote economic development and wealth creation, promote social development, and the improvement of the environment, all in Greater London. The GLA has power to do anything which it considers will further any one or more of its principal purposes. The investment activities of the GLA in LSR fall within these principal purposes.
- 6.8. Under section 34(1) the GLA may do anything it considers will facilitate or is conducive or incidental to the exercise of the section 30 principal purposes. Sections 30 and/or 34 provide the legal powers for the GLA to establish the Scottish GP and for LTL to become the sole company member of the GP on incorporation and thereby for the company to become an indirect wholly owned subsidiary of the GLA.
- 6.9. At the point that the GP becomes an indirect wholly owned GLA subsidiary company it becomes subject to local government law and relevant local government accounting and other financial practices. A public body cannot generally delegate its statutory powers to a subsidiary. Therefore, a balance has to be struck between the GLA (the Mayor and delegated GLA staff) approving a framework consistent with his statutory powers, within which the GP will operate on a day to day basis. The controls outlined in paragraphs 1.10 to 1.16 above strikes an appropriate balance and provide the GLA with the necessary degree of oversight and exercise of Mayoral powers but allows the GP sufficient autonomy to operate efficiently on a day to day basis.
- 6.10. As a wholly owned subsidiary the GP will be a regulated company under the Local Authorities (Companies) Order 1995 (as amended) which imposes duties on the company including as regards the identification of it as a GLA subsidiary on its company documentation, the access of the GLA auditors to its accounts and also the right for GLA elected members to inspect its meeting agendas and minutes. The GP will also be subject to legislative requirements applicable to other members of the GLA group including the Freedom of Information Act 2000.

- 6.11. The Mayor can authorise a GLA director under section 38 of the GLA Act to exercise the GLA's rights as a company member at company general and board meetings in order to acquire sole ownership and then exercise control of the company going forward.
- 6.12. In addition, local authority subsidiary companies cannot do things outside the powers of the authority that owns it.
- 6.13. The GLA will be required to become a limited partner in the SLP. The GLA has the power to do this pursuant to section 12 of the Local Government Act 2003 which states that the GLA has the authority to invest for any purpose relevant to its functions and section 30 which permits the GLA to do 'anything' that it considers will further any of its principal purposes (as summarised in paragraph 6.7 above).
- 6.14. Under section 38(1-2) of the GLA Act, the Mayor has the power to delegate authority to the Executive Director of Resources as proposed in this decision.

7. Planned delivery approach and next steps

- 7.1. LTL's variation of permissions is underway and is expected to be approved before July 2020. Subject to this decision, the other aspects of forming the GP and partnership can be undertaken in parallel, targeting a transfer date of 30 June 2020.

Appendices and supporting papers:

Appendices

None.

Supporting papers

- MD2207 Homes for Londoners Land Fund
- MD2303 Acquisition of London Treasury Limited and related matters
- MD2365 London Treasury Limited share capital
- MD2445 Treasury management update and amendment to strategy statement
- MD2615 Treasury Management Strategy Statement 2020-21 and the Mayor's Land Fund

Public access to information

Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FoIA) and will be made available on the GLA website within one working day of approval.

If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary. **Note:** This form (Part 1) will either be published within one working day after it has been approved or on the defer date.

Part 1 - Deferral

Is the publication of Part 1 of this approval to be deferred? NO

Part 2 - Sensitive information

Only the facts or advice that would be exempt from disclosure under FoIA should be included in the separate Part 2 form, together with the legal rationale for non-publication.

Is there a part 2 form - NO

ORIGINATING OFFICER DECLARATION:

Drafting officer to confirm the following (✓)

Drafting officer:

Luke Webster has drafted this report in accordance with GLA procedures and confirms the following:

✓

Sponsoring Director:

Martin Clarke has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.

✓

Mayoral Adviser:

David Bellamy has been consulted about the proposal and agrees the recommendations.

✓

Advice:

The Finance and Legal teams have commented on this proposal.

✓

Corporate Investment Board

This decision was agreed by the Corporate Investment Board on 16 March 2020.

EXECUTIVE DIRECTOR, RESOURCES:

I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature

M. D. Allge

Date

16.3.20

CHIEF OF STAFF:

I am satisfied that this is an appropriate request to be submitted to the Mayor

Signature

D. Bellamy

Date

17/3/2020