



To: The Executive Councillor for Finance & Resources:
Councillor Richard Robertson

Report by: Caroline Ryba – Head of Finance & S151 Officer

Relevant scrutiny committee: Strategy & Resources
09/10/2017
Scrutiny
Committee

Wards affected: All Wards

TREASURY MANAGEMENT HALF YEARLY UPDATE REPORT 2017/18

Key Decision

1. Executive summary

- 1.1 The Council has adopted The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (Revised 2011).
- 1.2 The Code requires as a minimum receipt by full Council of an Annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead, a half-year review report and an Annual Report (stewardship report) covering activities in the previous year.
- 1.3 This half-year report has been prepared in accordance with CIPFA's Code of Practice on Treasury Management and covers the following:-
 - The Council's capital expenditure (Prudential Indicators);
 - A review of compliance with Treasury and Prudential Limits for 2017/18;
 - A review of the Council's borrowing strategy for 2017/18;
 - A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
 - A review of the Council's investment portfolio for 2017/18; and;
 - An update on interest rate forecasts following economic news in the first half of the 2017/18 financial year.
- 1.4 In line with the Code of Practice, all treasury management reports have been presented to both Strategy & Resources Scrutiny Committee and to full Council.

2. Recommendations

- 2.1 The Executive Councillor is asked to recommend this report to Council, which includes the Council's estimated Prudential and Treasury Indicators 2017/18 to 2020/21.

3. Background

- 3.1 The Council is required to comply with the CIPFA Prudential Code (May 2013 edition) and the CIPFA Treasury Management Code of Practice (Revised November 2011). The Council is required to set prudential and treasury indicators, including an Authorised Limit for borrowing, for a three year period and should ensure that its capital plans are affordable, prudent and sustainable.
- 3.2 The Prudential and Treasury Codes of Practice are currently being reviewed by CIPFA, with the results expected by the end of this year, with implementation for 2018/19. Members will be kept updated with any proposed revisions as they become known.
- 3.3 The Council is currently supported in its treasury management functions by specialist advisors who are Capita Asset Services. Capita's services include the provision of advice to the Council on developments and best practice in this area and provide information on the creditworthiness of potential counterparties, deposits, borrowing, interest rates and the economy.

4. The Council's Capital Expenditure and Financing 2017/18 to 2020/21

- 4.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:
- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, developer contributions, revenue contributions, reserves etc.), which has no resultant impact on the Council's borrowing need; or;
 - If insufficient financing is available, or a decision is taken not to apply other resources, the funding of capital expenditure will give rise to a borrowing need.
- 4.2 Details of capital expenditure forms one of the required prudential indicators. The table below shows the proposed capital expenditure and how it will be financed. It also includes any re-phasing during 2017/18 and is in line with the agreed Capital Plan.

	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
General Fund Capital Expenditure	39,415	3,351	2,778	3,372
HRA Capital Expenditure	24,302	48,414	34,385	35,853
Total Capital Expenditure	63,717	51,765	37,163	39,225
Resourced by:				
• Capital receipts	-4,907	-11,860	-8,787	-5,598
• Other contributions	-44,810	-33,905	-28,376	-33,627
Total resources available for financing capital expenditure	-49,717	-45,765	-37,163	-39,225
Financed from cash balances	14,000	6,000	0	0

5. The Council's Prudential and Treasury Management Indicators

5.1 The table below shows the Capital Financing Requirement (CFR), which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Capital Financing Requirement & Cumulative External Borrowing	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
General Fund Capital Financing Requirement	24,697	30,697	30,697	30,697
HRA Capital Financing Requirement	214,321	214,321	214,321	214,321
Total Capital Financing Requirement	239,018	245,018	245,018	245,018
Movement in the Capital Financing Requirement	14,000	6,000	0	0
Estimated External Gross Debt/Borrowing				

Capital Financing Requirement & Cumulative External Borrowing	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
(Including HRA Reform)	213,572	213,572	213,572	213,572
Authorised Limit for External Debt	250,000	250,000	250,000	250,000
Operational Boundary for External Debt	239,018	245,018	245,018	245,018

- 5.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members.
- 5.3 The table below shows the Council's current outstanding debt and headroom (the amount of additional borrowing that is possible without breaching the Authorised Borrowing Limit):-

	Principal (£'000)
Authorised Borrowing Limit (A) – Agreed by Council on 20 th October 2011	250,000
HRA Debt Limit (B)	230,839
2011/12 Borrowing (for HRA Self-Financing, C)	213,572
General Fund Headroom (A minus B)	19,161
HRA Headroom (B minus C)	17,267
2012/13 Borrowing	NIL
2013/14 Borrowing	NIL
2014/15 Borrowing	NIL
2015/16 Borrowing	NIL
2016/17 Borrowing	NIL
2017/18 Borrowing up to 31 st August 2017	NIL
Total Current Headroom (A minus C)	36,428

- 5.4 During this financial year the Council has operated within the 'authorised' and 'operational' borrowing limits contained within the Prudential Indicators set out in the Council's Treasury Management Strategy Statement. The anticipated Prudential & Treasury indicators are shown in Appendix A.

6. Borrowing

- 6.1 The Council is permitted to borrow under the Prudential Framework, introduced with effect from 1st April 2004.
- 6.2 At present the only debt held by the authority relates to the twenty loans from the PWLB for self-financing the HRA taken out in 2012 totalling £213,572,000.
- 6.3 The Council's current capital plan does not require any new external borrowing for the period 2017/18 to 2020/21, inclusive. However, this will be kept under review as part of the development of the capital plan.
- 6.4 The provision for the repayment of debt is known as the Minimum Revenue Provision (MRP). Regulations require the authority to determine annually a policy by which MRP will be determined. This policy was agreed by Council in February 2017.
- 6.5 The Medium Term Financial Strategy now includes proposals for capital expenditure of up to £14.0 million in 2017/18 & up to £6.0 million in 2018/19, to be funded from internal borrowing.
- 6.6 In the event that external borrowing is undertaken the Council is able, as an eligible local authority, to access funds at the PWLB Certainty Rate (a 0.20% discount on loans) until 31 October 2018, at least (with the date agreed annually).

7. Investment Portfolio

- 7.1 The Council takes a cautious approach within its Treasury Management Strategy, and the detailed counterparty list with limits is shown within Appendix B. These limits have not been breached to date in 2017/18.
- 7.2 No changes to the counterparty list or limits are proposed as part of this half-year review.
- 7.3 The average rate of return for all deposits to 31st August 2017 is 1.11%, compared to an actual of 1.09% for 2016/17. The current quoted return on the CCLA Local Authorities Property Fund is an annual return of 4.46%. The Council has achieved its interest receipts budget of £581,600 to the end of August 2017. There is uncertainty of rates and levels of receipts for the second half of this year.

7.4 The table below shows the Council's predicted cash balances apportioned between short term (up to 3 months), medium term (up to 1 year) and long term (core cash, up to 5 years) deposits.

SUMMARY DEPOSIT ANALYSIS	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000
Short Term	43,900	43,700	45,100	50,500
Medium Term	25,100	25,000	25,800	28,900
Long Term	35,600	35,400	36,500	40,900
TOTAL PREDICTED CASH DEPOSITS:-	104,600	104,100	107,400	120,300

***Based on current estimated net cash inflow trends**

7.5 The Council's balances show a broadly upward trend.

7.6 An analysis of the sources of the Council's deposits is prepared from the audited balance sheet at the end of each financial year. The analysis for 31 March 2017 is shown at Appendix C.

8. Brexit Update

8.1 The referendum result has generated some uncertainty in the investment markets. Realistically, given the number of complexities of the situation, these uncertainties will take some time to clear.

8.2 Rates have dropped following Brexit. Article 50 has now been triggered and it is still not clear exactly what will happen. There are then two years to complete negotiations for leaving the EU, so the uncertainty is expected to continue in the medium term.

9. Financial Market Reforms Update

9.1 Basel III

9.2 Flowing from the banking crisis in 2008, this banking reform introduces new capital and liquidity standards to strengthen the regulation, supervision, stress testing and risk management of the whole of the banking and finance sector. It is a voluntary reform with a phased programme of implementation up to 2019.

9.3 The global capital framework and new capital buffers require financial institutions to hold more capital and higher quality of capital. The new leverage ratio introduces a non-risk based measure to supplement the risk based minimum capital requirements. The new liquidity ratios

ensure that adequate funding is maintained in case there are other severe banking crises.

9.4 Markets in Financial Instruments Directive II (MIFID II)

9.5 MiFID II and the accompanying Regulation on Markets in Financial Instruments and Amending Regulation (MiFIR) are both pieces of legislation that seek to provide a European-wide legislative framework for regulating the operation of financial markets in the European Union. These revised Regulations have an implementation date of 3rd January 2018. An increase in paper work will be inevitable but the onus will be on the counterparty to ascertain all of the criteria and to collect the required evidence.

9.6 Members have given the authority to invest in financial instruments in line with our current counterparty list as shown at Appendix B. However, these new regulations may restrict the use of some of the more regulated financial products that the Council currently uses. The Council will need to register with the various Financial Institutions, in order to carry on with these investments. Members will be updated when our registrations are complete.

9.7 Money Market Fund (MMF) Reforms

9.8 The Money Market Fund Regulation comes into force on 21st July 2018 which impacts immediately on any new funds created. Existing funds will have to be compliant by no later than 21st January 2019.

9.9 The above Regulation provides investors with a new way of categorising a MMF depending on the level of risk, which could cause fluctuations in their capital values.

9.10 No changes are required to the Council's current Treasury Strategy for 2017/18 but some changes will be required to the Council's Treasury Strategy for 2018/19, due to these reforms. Members will be updated when further developments are known and in time from when the Council sets its next Treasury Strategy (during February 2018).

10. Interest Rates

10.1 Capita Asset Services is the Council's independent treasury advisor. In support of effective forecasting the Council needs to be aware of the potential influence of interest rates on treasury management issues for the Council. Capita's opinion on interest rates is presented at Appendix D.

11. Implications

(a) **Financial Implications**

The prudential and treasury indicators have been amended to take account of known financial activities.

(b) **Staffing Implications**

None.

(c) **Equality & Poverty Implications**

No negative impacts identified.

(d) **Environmental Implications**

None.

(e) **Procurement**

None.

(f) **Consultation and communication**

None required.

(g) **Community Safety**

No community safety implications.

12. Background Papers

12.1 None were used in preparing this report.

13. Appendices

13.1 Appendix A – Prudential and Treasury Management Indicators

Appendix B – The Council's current Counterparty list

Appendix C – Sources of the Council's Deposits

Appendix D – Capita's opinion on UK Forecast Interest Rates

Appendix E – Glossary of Terms and Abbreviations

14. Inspection of Papers

14.1 If you have any queries about this report please contact:

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PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000
PRUDENTIAL INDICATORS				
Capital expenditure				
- General Fund	39,415	3,351	2,778	3,372
- HRA	24,302	48,414	34,385	35,853
Total	63,717	51,765	37,163	39,225
Incremental impact of capital decisions on:				
Band D Council Tax (City element) – Shown in £'s	£0.72	£0.06	£0.05	£0.06
Average weekly housing rent – Shown in £'s	£-3.11	£3.25	£0.45	£0.66
Capital Financing Requirement (CFR) as at 31 March				
- General Fund	24,697	30,697	30,697	30,697
- HRA	214,321	214,321	214,321	214,321
Total	239,018	245,018	245,018	245,018
Change in the CFR	14,000	6,000	0	0
Deposits at 31 March	104,632	104,079	107,415	120,310
External Gross Debt	213,572	213,572	213,572	213,572
Ratio of financing costs to net revenue stream				
-General Fund	-744	-735	-716	-866
-HRA	6,301	6,139	6,121	5,947
Total	5,557	5,404	5,405	5,081
% of net revenue expenditure				
-General Fund	-3.38%	-3.79%	-4.06%	-4.69%
-HRA	15.35%	15.01%	15.09%	14.17%
Total (%)	11.97%	11.22%	11.03%	9.48%

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000
TREASURY INDICATORS				
Authorised limit				
for borrowing	250,000	250,000	250,000	250,000
for other long term liabilities	0	0	0	0
Total	250,000	250,000	250,000	250,000
HRA Debt Limit				
Operational boundary				
for borrowing	239,018	245,018	245,018	245,018
for other long term liabilities	0	0	0	0
Total	239,018	245,018	245,018	245,018
Upper limit for total principal sums deposited for over 364 days & up to 5 years	50,000	50,000	50,000	50,000
Upper limit for fixed & variable interest rate exposure				
Net interest on fixed rate borrowing/deposits	6,748	6,757	6,776	6,626
Net interest on variable rate borrowing/deposits	-18	-15	-15	-15
Maturity structure of new fixed rate borrowing		Upper Limit	Lower Limit	
10 years and above (PWLB borrowing for HRA Reform)		100%	100%	

Treasury Management Annual Investment Strategy

Current Counterparty List

The full listing of approved counterparties is shown below, showing the category under which the counterparty has been approved, the appropriate deposit limit and current duration limits:-

Name	Council's Current Deposit Period	Category	Limit (£)
Specified Investments:-			
All UK Local Authorities	N/A	Local Authority	20m
All UK Passenger Transport Authorities	N/A	Passenger Transport Authority	20m
All UK Police Authorities	N/A	Police Authority	20m
All UK Fire Authorities	N/A	Fire Authority	20m
Debt Management Account Deposit Facility	N/A	DMADF	Unlimited
Barclays Bank Plc	Using Capita's Credit Criteria	UK Bank	25m
HSBC Bank Plc	Using Capita's Credit Criteria	UK Bank	20m
Standard Chartered Bank	Using Capita's Credit Criteria	UK Bank	20m
Bank of Scotland Plc (BoS)	Using Capita's Credit Criteria	UK Bank	20m
Lloyds TSB Bank Plc	Using Capita's Credit Criteria	UK Bank	20m
National Westminster Bank Plc (NWB)	Using Capita's Credit Criteria	UK Nationalised Bank	20m
Santander UK Plc	Using Capita's Credit Criteria	UK Bank	5m
The Royal Bank of Scotland Plc (RBS)	Using Capita's Credit Criteria	UK Nationalised Bank	20m
Other UK Banks	Using Capita's Credit Criteria	UK Banks	20m
Members of a Banking Group (RBS Group includes NWB)	Using Capita's Credit Criteria	UK Banks and UK Nationalised Banks	30m
Svenska Handelsbanken	Using Capita's Credit Criteria	Non-UK Bank	5m

Name	Council's Current Deposit Period	Category	Limit (£)
Enhanced Cash Funds (Standard & Poor's: AAAf/S1, Fitch: AAA/S1)	Over 3 months and up to 1 year	Financial Instrument	10m (per single counterparty)
Money Market Funds	Liquid Rolling Balance	Financial Instrument	15m (per fund)
Custodian of Funds	Requirement for Undertaking Financial Instruments	Fund Managers	Up to 15m (per single counterparty)
UK Government Treasury Bills	Up to 6 months	Financial Instrument	15m
Other Specified Investments - UK Building Societies:-			
Name	Council's Current Deposit Period	Asset Value (£'m) – as at 10 th August 2017	Limit (£)
Nationwide Building Society	1 month or in line with Capita's Credit Criteria, if longer	220,013	Assets greater than £100,000m - £20m
Yorkshire Building Society		45,162	
Coventry Building Society		37,632	Assets between £50,000m and £99,999m - £5m
Skipton Building Society		17,827	
Leeds Building Society		16,485	
Principality Building Society		8,124	Assets between £5,000m and £49,999m - £2m
West Bromwich Building Society		5,839	
Non-Specified Investments:-			
Name	Council's Current Deposit Period	Category	Limit (£)
All UK Local Authorities – longer term limit	Over 1 year and up to 5 years	Local Authority	Up to 35m (in total)
Cambridge City Council Housing Working Capital Loan Facility	Up to 1 year	Loan	200,000
CCLA Local Authorities' Property Fund	Minimum of 5 years	Pooled UK Property Fund	Up to 15m
Certificates of Deposit (with UK Banking Institutions)	Liquid Rolling Balance	Financial Instrument	15m (per single counterparty)
Certificates of Deposit (with UK Building Societies)	Liquid Rolling Balance	Financial Instrument	2m (per single counterparty)

Name	Council's Current Deposit Period	Category	Limit (£)
Certificates of Deposit (with Foreign Banking Institutions)	Liquid Rolling Balance	Financial Instrument	2m (per single counterparty)
Enhanced Cash Funds (Standard & Poor's: AAAf/S1, Fitch: AAA/S1)	Over 1 year and up to 5 years	Financial Instrument	10m (per single counterparty)
Commercial Property Investments funded from cash balances	Over 1 year	Commercial Property	20m (in total)
Municipal Bonds Agency	N/A	Pooled Financial Instrument Facility	50,000
Supranational Bonds – AAA	Using Capita's Credit Criteria	Multi-lateral Development Bank Bond	15m
UK Government Gilts	Over 1 year & up to 30 Years	Financial Instrument	15m

Note: In addition to the limits above, the total non-specified items over 1 year will not exceed £50m.

Sources of the Council's Deposits

Local authorities are free to deposit surplus funds not immediately required in order to meet the costs of providing its services. The Council deposits amounts set aside in its general reserves and earmarked reserves.

The interest earned on these deposits is credited to the General Fund and Housing Revenue Account respectively and helps to fund the cost of providing services. This currently amounts to around £1.4m each year based on current deposit and interest rate levels.

At 1st April 2017, the Council had deposits of £110.708m. The table below provides a sources breakdown of the funds deposited at that date:-

Funds Deposited as at 1 April 2017	£'000	£'000
Working Capital		26,279
General Fund:		
General Reserve	15,413	
Asset Renewal Reserves	3,615	
Other Earmarked Reserves	20,355	39,383
Housing Revenue Account (HRA):-		
General Reserve	10,178	
Asset Renewal Reserves	2,252	
Major Repairs Reserve	5,549	
Other Earmarked Reserves	1,991	
Capital Financing Requirement (Including HRA Reform)	-225,017	
PWLB Borrowing for HRA Reform	213,572	8,525
Capital:		
Capital Contributions Unapplied	4,229	
Usable Capital Receipts	32,292	36,521
Total Deposited		110,708

The HRA accounts for around 43% of reserves deposited.

Capita's Opinion on Forecast UK Interest Rates – As Currently Predicted

Introduction

The paragraphs that follow reflect the views of the Council's Treasury Management advisors (Capita) on UK Interest Rates as currently predicted.

Interest rates

Members of the Bank of England Monetary Policy Committee (MPC) reduced the bank rate to 0.25% (previously 0.50%) and increased Quantitative Easing (QE) by £60bn to £435bn, on 4th August 2016. Going forward, the Council's treasury advisor, Capita, has provided the following interest rate forecasts, issued on 9th August 2017:-

	Now	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3 month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 month LIBID	0.60%	0.60%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB rate	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	1.90%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.60%	2.80%	2.30%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.40%	2.60%	2.10%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

This is the first bank rate change since 2009. The actual vote on 4th August 2016 was unanimous at 9-0 in favour. The actual vote on 14th September 2017 was 7-2 for no change.

Treasury Management – Glossary of Terms and Abbreviations

Term	Definition
Authorised Limit for External Borrowing	Represents a control on the maximum level of borrowing
Capital Expenditure	Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day to day items including employees' pay, premises costs and supplies and services)
Capital Financing Requirement	A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources
Certificates of Deposit (CDs)	Low risk certificates issued by banks which offer a higher rate of return
CIPFA	Chartered Institute of Public Finance and Accountancy
Corporate Bonds	Financial instruments issued by corporations
Counter-parties	Financial Institutions with which funds may be placed
Credit Risk	Risk of borrower defaulting on any type of debt by failing to make payments which it is obligated to do
DCLG	Department for Communities & Local Government
Enhanced Cash Funds	Higher yielding funds typically for investments exceeding 3 months
Eurocurrency	Currency deposited by national governments or corporations in banks outside of their home market
External Gross Debt	Long-term liabilities including Private Finance Initiatives and Finance Leases
HRA	Housing Revenue Account - a 'ring-fenced' account for local authority housing account where a council acts as landlord
HRA Self-Financing	A new funding regime for the HRA introduced in place of the previous annual subsidy system
London Interbank Offered Rate (LIBOR)	A benchmark rate that some of the leading banks charge each other for short-term loans
London Interbank Bid Rate (LIBID)	The average interest rate which major London banks borrow Eurocurrency deposits from other banks
Liquidity	A measure of how readily available a deposit is
MPC	Monetary Policy Committee - The Bank of England Committee responsible for setting the UK's bank base rate
Non-Specified Investments	These are investments that do not meet the conditions laid down for Specified Investments and potentially carry additional risk, e.g. lending for periods beyond 1 year

Term	Definition
Operational Boundary	Limit which external borrowing is not normally expected to exceed
PWLB	Public Works Loans Board - an Executive Government Agency of HM Treasury from which local authorities & other prescribed bodies may borrow at favourable interest rates
Quantitative Easing (QE)	A financial mechanism whereby the Central Bank creates money to buy bonds from financial institutions, which reduces interest rates, leaving businesses and individuals to borrow more. This is intended to lead to an increase in spending, creating more jobs and boosting the economy
Security	A measure of the creditworthiness of a counter-party
Specified Investments	Those investments identified as offering high security and liquidity. They are also sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum 'high' credit rating criteria where applicable
Supranational Bonds	Multi-lateral Development Bank Bond
UK Government Gilts	Longer-term Government securities with maturities over 6 months and up to 30 years
UK Government Treasury Bills	Short-term securities with a maximum maturity of 6 months issued by HM Treasury
Yield	Interest, or rate of return, on an investment