Manchester City Council
Report for Information

Report to: Audit Committee – 17 July 2014

Subject: Treasury Management Annual Report 2013-14

Report of: City Treasurer

Purpose

To report the Treasury Management activities of the Council 2013-14.

Recommendations

The Audit Committee is asked to note the contents of the report, and recommend to Council;

a) a change to the investment strategy for 2014-15, which involves setting the minimum short-term rating that the Council will accept for a counterparty at F2 (Fitch) or equivalent, this is highlighted in Section 8.
b) a change to the borrowing strategy for 2014-15, which involves the possible use of the Homes & Communities Agency/ Communities & Local government loan facility, this is highlighted in Section 9.

Wards Affected:

Not Applicable

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Background documents (available for public inspection):

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2013-14 (Executive Committee 13 February 2013)

1 Introduction and Background

1.1 Treasury Management in Local Government is regulated by the CIPFA Code of Practice on Treasury Management in Local Authorities. The City Council has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Chief Financial Officer responsibilities, and delegation and reporting arrangements. This was approved by the Council on the 7th of March 2013 as part of the Treasury Management Strategy Statement for 2013-14.

1.2 CIPFA amended the CIPFA Treasury Management in the Public Services Code of Practice in late 2011, and the revised Code recommended that local authorities include, as part of their Treasury Management Strategy Statement, the requirement to report to members at least twice a year on the activities of the Treasury Management function. This report, along with the interim Treasury Management report received by the Audit Committee on the 28th of November 2013, therefore ensures that the Council meets the requirements of the Strategy, and therefore the Code.

1.3 Treasury Management in this context is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.4 This outturn report covers:

Section 1: Introduction and Background
Section 2: The Council's Portfolio Position as at 31st March 2014
Section 3: Borrowing Strategy for 2013-14
Section 4: Treasury Borrowing in 2013-14
Section 5: Compliance with Treasury Limits and Prudential Indicators
Section 6: Investment Strategy for 2013-14
Section 7: Temporary Borrowing and Investment Outturn for 2013-14
Section 8: Investment Strategy for 2014-15
Section 9: Borrowing Strategy for 2014-15
Section 10: Banking Contract
Section 11: Conclusion

Appendix A: PWLB Interest Rates
Appendix B: Treasury Management Prudential Indicators
Appendix C: Glossary of Terms

2 Portfolio Position as at 31st March 2014

2.1 The last year has seen an interest rate differential between the cost of long term debt (3.6% to 4.7%) and the return available from short term investments (under 1%) which led to the council following a strategy of borrowing internally (using cash backed reserves). As well as the cost of carry (paying out more interest on long term borrowing then can be earned from short term investing), there is also a difficulty in finding suitable organisations to lend surplus cash to as fewer of them meet our criteria since the banking crisis.

2.2 The Treasury Management Strategy for 2013-14 highlighted that there was a need to undertake some borrowing in 2013-14 to fund the capital programme. The strategy made clear that permanent borrowing would be considered after cash balances had been utilised, as such internal borrowing would be the cheapest form of funding in the current economic environment. During the year cash balances have been relatively high and so only £30m of additional 'long term' borrowing (for 2 or 3 years) has been taken.

2.3 The Council's debt position at the beginning and the end of the year was as follows:

Loan Type	31 March 2013 Principal £m	31 March 2013 Average Rate %	31 March 2014 GF £m	31 March 2014 HRA £m	31 March 2014 Principal £m	31 March 2014 Average Rate %
PWLB	0.0	0.00	0.0	0.0	0.0	0.00
Temporary Borrowing *	15.0	0.41	8.1	0.0	8.1	0.22
Market Loans	470.2	4.91	419.7	71.5	491.2	4.62
Stock	8.1	3.37	8.1	0	8.1	3.37
Gross Total	**493.3**	**4.75**	**435.9**	**71.5**	**507.4**	**4.53**
Temporary Deposits	(9.2)	0.71	(49.5)	0.0	(49.5)	0.44
Internal balances (GF/HRA)	0.0	0.0	21.7	(21.7)	0.0	0.0
Net Total	**484.1**	**4.83**	**408.1**	**49.8**	**457.9**	**4.97**

***** Temporary borrowing at 31 March 2014 consisted of £495k from the Manchester International Festival, £3.03m from the Manchester Mortgage Corporation Ltd and £4.6m from the Homes & Communities Agency/ Communities and Local Government.

2.4 The temporary borrowing and deposit figures fluctuate daily to meet the daily cash flow requirements of the council. The figures for these categories in the table above are therefore only a snapshot at a particular point in time.

2.5 New long term borrowing of £30m was taken during the year, with £10m of long term borrowing repaid. Towards the end of the year the Council was approached by several local public sector organisations with requests to lend money to the Council in order to achieve an investment return, as such a facility was not available to them through their bank. The Council has borrowed a further £9.1m this way, with £8.1m of this deemed to be temporary borrowing due to the facility offered.

3 Borrowing Strategy for 2013-14

3.1 The expectation for interest rates within the strategy for 2013-14 was for the Bank Rate to remain at 0.50% throughout the year. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

3.2 In this scenario, the treasury strategy becomes a balance between postponing borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk, and taking borrowing to 'lock-in' long term borrowing at historically low rates and mitigate against the risk of delaying and borrowing at higher rates.

3.3 Ultimately, due to continued concerns regarding the level of inflation and the underlying strength of the economy, the Bank Rate remained at its historic low of 0.5% throughout the year. As detailed above, the Council has held significant cash balances throughout the year and so there has been no requirement to borrow.

4 Treasury Borrowing in 2013-14

4.1 PWLB interest rates have fluctuated but have shown an upward trend across the financial year, particularly at shorter maturity rates, as shown in the graph at Appendix 2. This is in part due to concerns regarding expected future interest rate increases by the Bank of England.

PWLB Borrowing Rates 2013-14 for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11	1.70	2.71	3.91	4.04
Date	02/04/2013	08/04/2013	23/04/2013	08/04/2013	08/04/2013
High	1.43	3.00	4.11	4.68	4.71
Date	27/12/2013	02/01/2014	02/01/2014	11/09/2013	11/09/2013
Average	1.30	2.46	3.58	4.43	4.46

4.2 The rates above reflect the fact that since the 1st of November 2012 the Government has reduced by 0.2% the interest rates on loans from the PWLB to local authorities who provide information to Government on their plans for long-term borrowing and associated capital spending. The Council provided the required information, and can therefore access the Certainty Rate.

4.3 New long term borrowing of £30m was taken from other local authorities and a fire authority during the year. The table below shows the interest rates on these loans compared to the PWLB Certainty rate on that date.

Date loans taken	Average loan rate	Duration (yrs)	PWLB Certainty rate
19th August 2013	1.05 %	3	1.29%
19th August 2013	0.90%	2	1.14%

5 Compliance with Treasury Limits

5.1 During the financial year, the Council operated within the treasury limits and Prudential Indicators set out in the Treasury Management Strategy Statement. Performance against the treasury targets is shown in Appendix 3.

6 Investment Strategy for 2013-14

6.1 The Treasury Management Strategy Statement (TMSS) for 2013-14 was approved by Council on 7th of March 2013. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as:

a) the security of capital; and
b) the liquidity of investments.

6.2 In order to achieve a higher level of security the City Treasurer introduced the following measures:

- Investments to be restricted to UK banks, building societies, local authorities and government institutions.
- Diversify the investment portfolio into more secure UK government and government backed institutions.
- Although the investment strategy allows investments up to 364 days, restrict deposits to as short a time period as feasible.

6.3 The City Council's temporary cash balances are managed by the City Treasurer in-house and invested with those institutions listed in the City's Approved Lending List. On four occasions during the year these limits were breached, albeit temporarily and by relatively small amounts, due to interest being paid at the close of business by the banks. On two occasions the breach was rectified as soon as officers became aware of the issue, on a further two occasions the interest amount was disputed with the bank, and the issue rectified once the dispute had been resolved.

7 Temporary Borrowing and Investment Outturn 2013-14

7.1 Investment rates available in the market continue to be at an historic low point. The average level of funds available for investment purposes in 2013-14 was just over £65.5m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants, and progress on the capital.

7.2 The average level of temporary borrowing during the financial year, excluding those days when no temporary borrowing was required, was £17.2m. Of this £10.m was held for 16 days and £7.2m for 1 day in 2013-14.

7.3 Detailed below is the result of the temporary investment and borrowing undertaken by the Council. As illustrated, the authority outperformed the benchmark by 11 basis points on investments and 4 basis points on borrowing.

	Average temporary Investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£65.5m	0.46%	0.35%
Temporary Borrowing	£17.2m	0.44%	0.48%

* *Average 7-day LIBID / LIBOR rate sourced from Sector*

7.4 None of the institutions in which investments were made show any difficulty in repaying investments and interest in full during the year. The list of institutions in which the Council invests is kept under continuous review. It remains the Council's policy not to invest with institutions based outside the UK, including those in Ireland.

8 Investment Strategy for 2014-15

8.1 The strategy for 2014-15 was agreed by the Council on the 7th of March 2014. Within the strategy the ratings thresholds for acceptable investment counterparties were laid out.

8.2 In the time since the strategy was accepted the ratings agencies have begun a process of reviewing the ratings of all banks and building societies, in the light of changes to banking law which suggest implied sovereign support of banks (e.g. the likelihood of a government stepping in to save an ailing bank) has weakened.

8.3 The Council only invests in UK banks and building societies which for the most part have had ratings bolstered by implied sovereign support, in particular those which are part state-owned. The ratings of these institutions have therefore come under pressure and are under review.

8.4 Historically investment decisions for the Council have been based on the long term rating of the counterparty, but the strategy has included a minimum short term rating criteria – namely Fitch F1 or equivalent, which is the second highest short term credit rating. The ratings agencies reviews have placed pressure on the short term ratings of the Council's existing counterparties.

8.5 For the authority to maintain the current counterparty list the minimum short term rating criteria needs to be reduced to F2 (Fitch) or equivalent. This would align it with the current minimum long-term rating used by the Authority (A-), as it is considered the short term equivalent of the long term ratings between A and BBB+.

8.6 Members are therefore asked to recommend to Council setting the minimum short-term rating that the Council will accept for a counterparty at F2 (Fitch) or equivalent.

9 Borrowing Strategy for 2014-15

9.1 The Homes & Communities Agency (HCA)/ Communities and Local Government (CLG) have offered the Council a loan facility through the Local Infrastructure Fund. The loan will act as a PWLB loan, but be with the HCA rather than the Treasury. The loan can be for between 1 and 5 years.

9.2 The HCA have allowed for flexible draw down of the loan, which is for c. £18.8m, with the loan split into two tranches. The tranches are available to be drawn down until the 31st March 2015, but there is no legal requirement on the Council to draw down the funds. The benefits of utilising this facility are that it can be fixed for 2 months in advance and repaid without penalty.

9.3 Such a facility was not included within the list of borrowing sources contained within the Treasury Management Strategy approved by Council in March 2014. Members are therefore asked to recommend to Council the use of the HCA facility as part of the borrowing strategy for 2014-15.

9.4 The HCA funds are only available at the same interest rates as PWLB, so draw down of monies would only be undertaken in the same circumstances as when drawing down from the PWLB would also be justified.

10 Banking Contract

10.1 Since the Co-op bank announced that it would no longer bid for local authority banking contracts last year, the Council has been involved in a Greater Manchester-wide tender process to find a new provider of banking services. This process is ongoing.

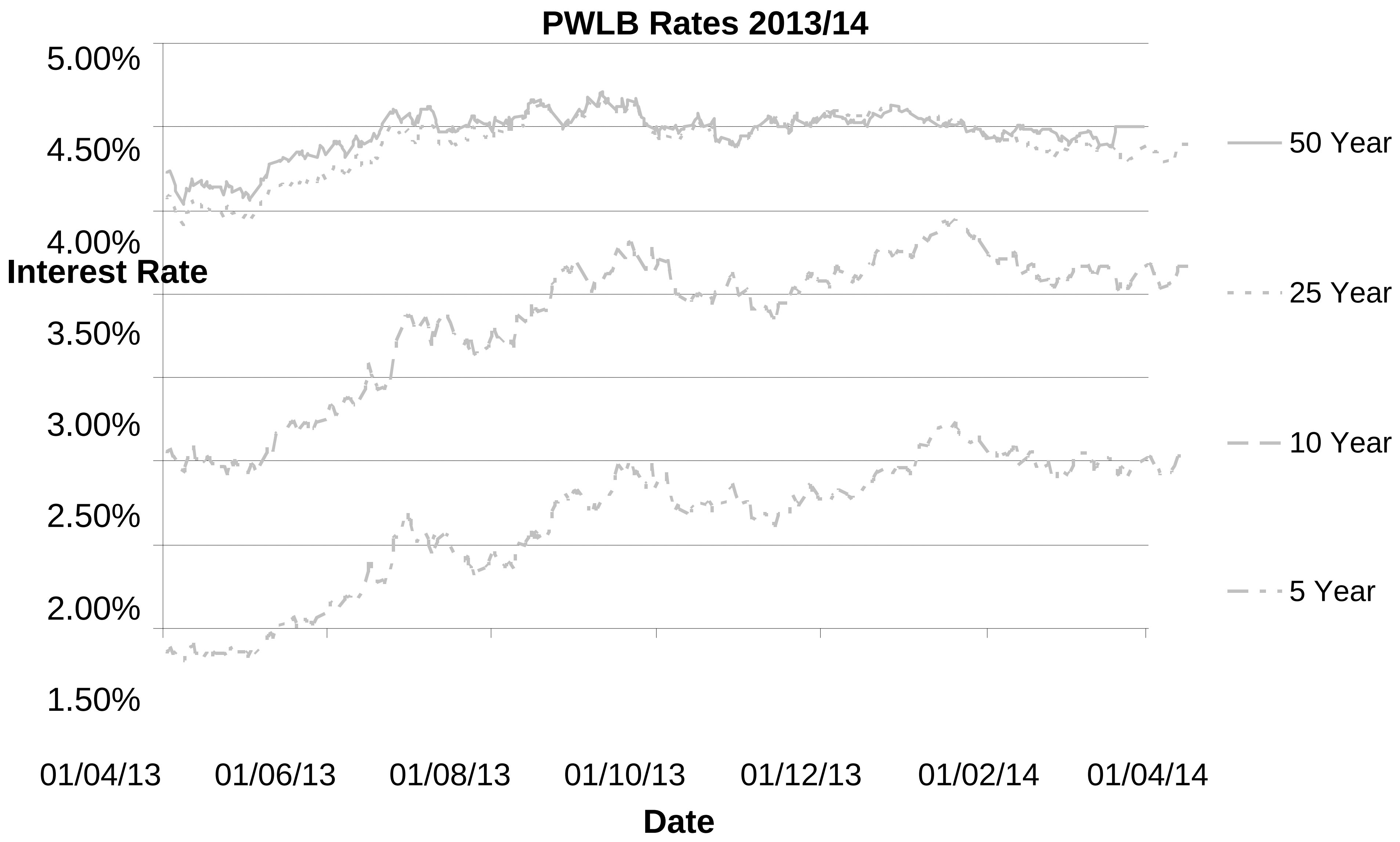
10.2 The Co-op bank has been clear that, whilst they will honour existing contracts, as part of their cost-saving measures they anticipate reductions in the level of service provided to local authority clients after 31st March 2015. Members are therefore asked to note that it is likely that the City Council will seek to switch banking providers around that date, along with 7 other local authorities, the Greater Manchester Combined Authority and Transport for Greater Manchester.

11 Conclusion

11.1 The current borrowing position reflects the strong balance sheet of the council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows etc). As cash balances have been relatively high, and it remains our policy to keep cash as low as possible and not to borrow in advance of need for capital purposes, only £30m of long term borrowing has been taken this year.

11.2 Proactive treasury management during the year has enabled us to achieve an average net return on our investments of 0.46%, which is better than the Benchmark Average 7-day LIBID rate of 0.35% and an average net cost of temporary borrowing of 0.44% which is better then the benchmark of 0.48%.

11.3 Consideration will be given to further borrowing during the 2014-15 financial year depending on the interest rates available and the need to borrow to meet the council's cash needs. Whilst the council has in the past made substantial use of market funds there is less availability in the market since the 'credit crunch' and PWLB loans are seen as providing more certainty and better value. However all alternatives available will be considered.


PWLB Rates 2013/14
5.00%
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
Interest Rate
01/04/13
01/06/13
01/08/13
01/10/13
01/12/13
01/02/14
01/04/14
Date
50 Year
25 Year
10 Year
5 Year

Appendix B

Treasury Management Prudential Indicators: 2013-14

	Original £m	Minimum In Year to 31 Mar 2014 £m	Maximum In Year to 31 Mar 2014 £m
Operational Boundary for External Debt:			
Borrowing	745.5	468.3	528.3
Other Long Term Liabilities	160.0	146.9	146.9
Authorised Limit for External Debt:			
Borrowing	852.1	468.3	528.3
Other Long Term Liabilities	160.0	146.9	146.9
		Actual as at 31 Mar 2014	
Authority has adopted CIPFA's Code of Practice for Treasury Management in the Public Services	Yes	Yes	
Upper Limits for Interest Rate Exposure:			
Net Borrowing at Fixed Rate as a percentage of Total Net Borrowing	95%	64.7%	
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	64%	35.3%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit** 2013-14 Original	**Upper Limit** 2013-14 Original	**Actual as at 31 Mar 2014**
under 12 months	0%	60%	0%
12 months and within 24 months	0%	90%	33.7%
24 months and within 5 years	10%	90%	62.4%
5 years and within 10 years	0%	60%	1.1%
10 years and above	0%	60%	2.8%

Appendix C

Glossary of Terms

Authorised Limit - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Counterparty – one of the opposing parties involved in a borrowing or investment transaction

Credit Rating – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount – Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

High/Low Coupon – High/Low interest rate

LIBID (London Interbank Bid Rate) – This is an average rate, calculated from the rates at which individual major banks in London are willing to borrow from other banks for a particular time period. For example, 6 month LIBID is the average rate at which banks are willing to pay to borrow for 6 months.

LIBOR (London Interbank Offer Rate) – This is an average rate, calculated from the rates which major banks in London estimate they would be charged if they borrowed from other banks for a particular time period. For example, 6 month LIBOR is the average rate which banks believe they will be charged for borrowing for 6 months.

Liquidity – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO (Lender Option Borrower Option) – This is a type of loan where, at various periods known as call dates, the lender has the option to alter the interest rate on the loan. Should the lender exercise this option, the borrower has a corresponding option to repay the loan in full without penalty.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

Monetary Policy Committee – the independent body that determines Bank Rate.

Operational Boundary – This Prudential Indicator is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Premium – Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. Part of the Government's Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

Specified Investments - Sterling investments of not more then one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

Non-specified investments - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

Variable Rate Funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.