Manchester City Council
Report for Information

Report to:	Audit Committee – 3 December 2014
Subject:	Treasury Management Interim Report 2014-15
Report of:	City Treasurer

Purpose

To report the Treasury Management activities of the Council during the first six months of 2014-15.

Recommendations

The Audit Committee is asked to note the contents of the report.

Wards Affected

All

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Background documents (available for public inspection):

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2014-15 (Executive Committee 12 February 2014)

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 8th October 2003, and updated and approved by the Executive on the 10th February 2010.

1.2 CIPFA amended the CIPFA Treasury Management in the Public Services Code of Practice in late 2009, 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. The recommendation was included within the Treasury Management Statement Strategy approved by the Executive on the 10th February 2010, and by Council on the 3rd March 2010. This report therefore ensures that the Council meets the requirements of the Strategy, and therefore the Code.

1.3 The Code was revised in November 2011, acknowledging the effect the Localism Bill could have on local authority treasury management, however there were no major changes to the Code. This report has been prepared in accordance with the revised November 2011 Code.

1.4 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”.

1.5 This interim report covers:

Section 1: Introduction and Background
Section 2: The Council’s Portfolio Position as at 30th September 2014
Section 3: Review of Economic Conditions
Section 4: External Borrowing in 2014-15 to date
Section 5: Compliance with Treasury Limits and Prudential Indicators
Section 6: Investment Strategy for 2014-15 to date
Section 7: Temporary Borrowing and Investment for 2014-15 to date
Section 8: Banking Contract
Section 9: Conclusion

Appendix A: PWLB Interest Rates
Appendix B: Treasury Management Prudential Indicators
Appendix C: Review of Economic Conditions, provided by advisors
Appendix D: Glossary of Term

2 Portfolio Position as at 30th September 2014

2.1 As outlined in the approved Treasury Management Strategy for 2014-15 it was anticipated that there would be a need to undertake some permanent borrowing in 2014-15 to fund the capital programme and to replace some of the internal funds. However, cash balances during the year have been relatively high and, as it remains the policy to keep cash low and minimise temporary investments, no borrowing activity has been undertaken during the year to date.

2.2 The Council's debt position at the beginning of the financial year, at the end of September (6 months) and end of October for comparison was as follows:

Loan Type	31-Mar-14		30-Sep-14		31-Oct-14	
	Principal	Average Rate	Principal	Average Rate	Principal	Average Rate
	£m	%	£m	%	£m	%
PWLB	0	0	0	0	0	0
Temporary Borrowing	8.1	0.22	4.2	0.5	4.4	0.5
Market Loans	491.2	4.62	495.7	4.62	495.7	4.62
Stock	8.1	3.37	8.1	3.37	8.1	3.37
Gross Total	**507.4**	**4.53**	**508**	**4.57**	**508.2**	**4.57**
Temporary Deposits	-49.5	0.44	-85.8	0.38	-67.2	0.41
Net Total	**457.9**	**4.97**	**422.2**	**4.95**	**441**	**4.98**

Note: In the table above HCA monies of £4.5m have been reclassified in 2014-15 from temporary borrowing to market loans.

2.3 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.

2.4 It is expected that from late December 2014 to mid March 2015 the Council will need to undertake some periods of short term borrowing due to temporary shortfalls in cash balances resulting from timing of payments and receipts. However, it is forecast that the position at the end of the year will be a surplus of c.£25m if the level of payments and receipts continues at the current level. This forecast position is reviewed at the end of each month.

2.5 The current cash flow forecast excludes a number of large receipts, the amount and timing of each is currently uncertain.

3 Review of Economic Conditions: April to September 2014

3.1 In September the Bank of England left the key lending rate at a record low of 0.5%, where it has been since March 2009. The concerns expressed in the Councils past reports about many banks being reluctant to lend, thereby limiting opportunities for the Council to borrow from the market, continue to exist.

3.2 There remains concern that the new bank liquidity regime being pursued by the FSA may further impact the ability of the Authority to achieve interest rates above the base rate on short term deposits. The Treasury Management function is actively researching alternative options which may protect the average rate achieved on deposits, should the regime be implemented as planned.

3.3 All three of the credit ratings agencies are due to remove the Implied Sovereign Support element of the credit rating. This is in reaction primarily to European regulatory changes which are due to come into effect in January 2016, but it is likely rating changes could happen before this date.

3.4 The impact of these changes may result in the downgrading of the credit ratings of some of the Council's counterparties, meaning the Council may have to reduce the amounts held with them therefore making the task of placing monies more difficult.

3.5 Appendix C provides a more detailed review of the recent economic situation.

4 Treasury Borrowing in 2014-15 to date

4.1 PWLB interest rates during the first 6 months of the year are illustrated in the table below and the graph at Appendix A.

PWLB Borrowing Rates 2014-15 to date for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.40%	2.70%	3.36%	3.95%	3.92%
Date	14/04/2014	14/04/2014	28/04/2014	29/08/2014	29/08/2014
High	1.69%	3.07%	3.86%	4.49%	4.48%
Date	16/07/2014	07/07/2014	07/07/2014	04/04/2014	02/04/2014
Average	1.55%	2.89%	3.61%	4.22%	4.20%

4.2 Manchester is on the approved list of authorities that can access the PWLB Certainty Rate going forward, giving the Council access to a 20 basis points reduction on the published PWLB rates.

4.3 The cash flow has proved to be highly variable this year, due mainly to the profile of the Revenue Support Grant which the Council receives from central government. The Council are working with the Department for Communities and Local Government to look at how the payments and receipts of this grant can be profiled in future years, as the current methodology makes efficient cash management very difficult to achieve.

4.4 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. The details of the loan arrangement and eligible projects are currently under discussion between the HCA and the Council.

4.5 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.

4.6 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.

4.7 The Council is in the process of discussing a £100m facility with the European Investment Bank (EIB) which will form part of the Councils overall borrowing strategy. The EIB's rates for sterling borrowing are currently favourable to PWLB, allowing for existing planned future borrowing from PWLB to be replaced by cheaper funding from the EIB. It is expected that the facility will be drawn down and utilised over 2015/16 to 2017/18. Whilst the bank appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, any monies borrowed are part of the councils overall pooled borrowing. Whilst it is hoped the facility will be agreed shortly, there are some important issues that remain outstanding.

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 B.

6 Investment Strategy for 2014-15 to date

6.1 The Treasury Management Strategy Statement (TMSS) for 2014-15 was approved by Executive on 12th February 2014. 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) 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. Officers can confirm these institutions meet the security criteria set out in the Annual Investment Strategy and the approved limits were not breached in the first half of 2014-15.

6.4 An amendment to the Treasury Strategy was made in September 2014, to permit the use of HCA funding and to allow no MRP to be charged in relation to capital expenditure funded by the proposed HCA loan.

7 Temporary Borrowing and Investment Outturn 2014-15 to date

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 the first six months of 2014-15 was just over £124m. 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 programme.

7.2 Detailed below is the temporary investment and borrowing undertaken by the Council. As illustrated, the authority underperformed the benchmark by 1 basis point on investments due to the inter local authority market being relatively depressed.

7.3 The temporary borrowing consists of funds the Council holds for Manchester organisations that work closely with the Council. It was agreed the Council would pay interest on their funds in line with the base rate, which is why the Council are above the benchmark cost.

	Average temporary investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£124.2m	0.34%	0.35%
Temporary Borrowing	£4.2m	0.50%	0.47%

* *Average 7-day LIBID 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. Banking Contract

8.1 The Council's new banking contract has been awarded to Barclays Bank Plc. It is planned for the Council to migrate its business across by the 1st April 2015.

9. Conclusion

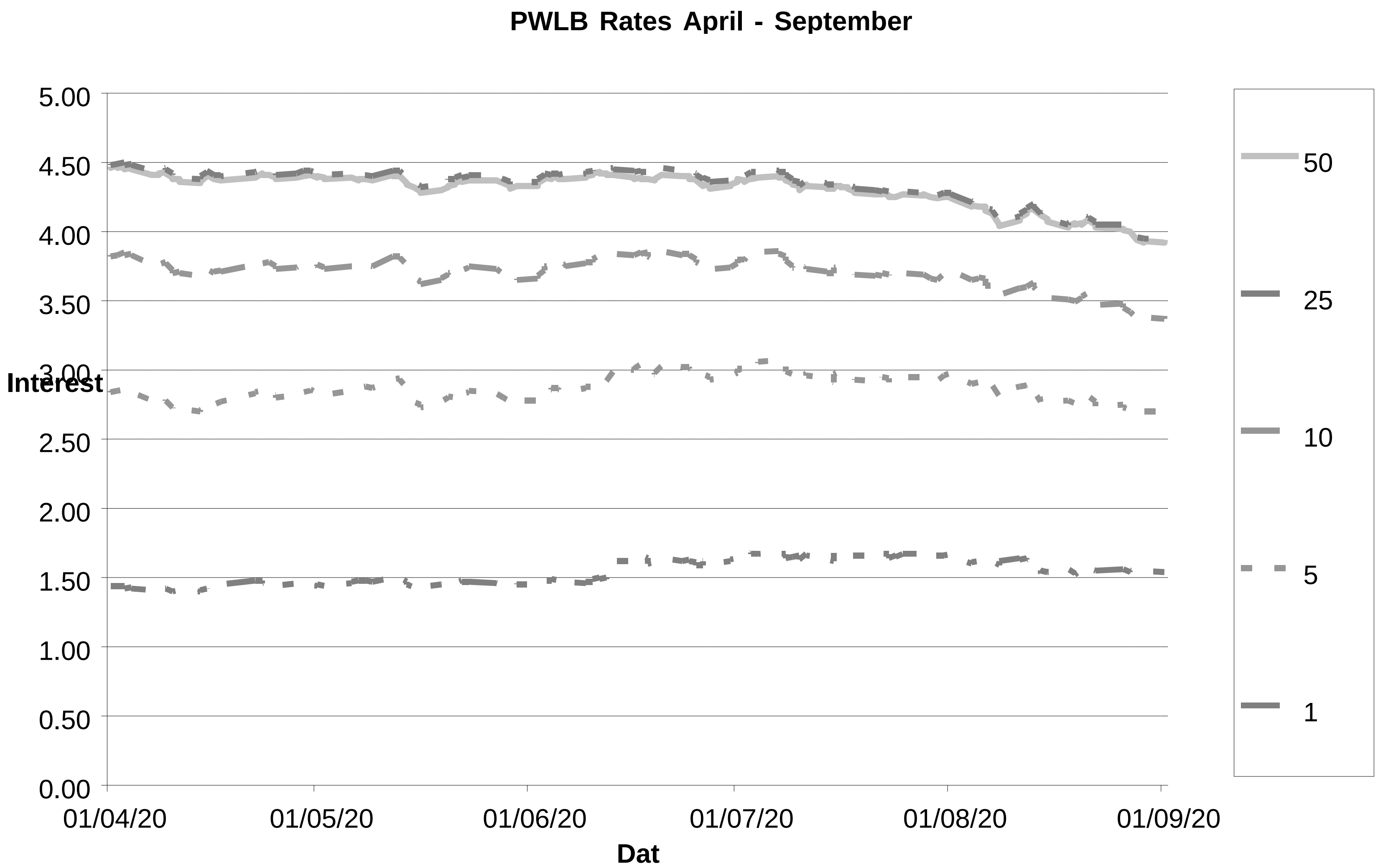
9.1 The current borrowing position reflects the strong balance sheet of the Council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows etc). As cash balances have been relatively high, and it remains the Council policy to keep cash as low as possible and not to borrow in advance of need for capital purposes.

9.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on our investments of 0.34%, which although less than the benchmark average 7-day LIBID rate of 0.35% is higher than the rate offered by the DMO, which is the default option if there are no offers in the inter local authority market .

9.3 Officers will monitor the changes that may result from the downgrading in credit ratings, and take the necessary action to ensure the Council still adheres to its Treasury Management Strategy. This however, will limit the investment options available to the Council.

9.4 Officers will continue to monitor the market for any opportunities to renegotiate the Council's existing debt, and also to source funding for future borrowing at below current rates. A further update on the treasury management position of the authority will be provided at the end of the financial year.

Appendix A


PWLB Rates April - September
5.00
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4.00
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Interest
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APPENDIX B
Treasury Management Prudential Indicators: 2014-15 to date

	Original £m	Minimum In Year to 30 Sept 2014 £m	Maximum In Year to 30 Sept 2014 £m
Operational Boundary for External Debt:			
Borrowing	987.2	507.7	508.1
Other Long Term Liabilities	216.0	161.3	161.3
Authorised Limit for External Debt:			
Borrowing	807.3	507.7	508.1
Other Long Term Liabilities	216.0	161.3	161.3
		Actual as at 30 Sept 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%	67%	
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	77%	33%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

	Lower Limit	**Upper Limit**	
Maturity structure of Fixed Rate Borrowing	**2014-15 Original**	**2014-15 Original**	**Actual as at 30 Sept 2014**
under 12 months	0%	60%	0%
12 months and within 24 months	0%	90%	46%
24 months and within 5 years	10%	80%	48%
5 years and within 10 years	0%	60%	3%
10 years and above	0%	60%	3%

APPENDIX C

REVIEW OF ECONOMIC CONDITIONS APRIL TO SEPTEMBER 2014

This section has been prepared by the Authority's Treasury Advisors, Capita, and includes their forecast for future interest rates.

1 Economic performance to date

1.1 After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, and 0.8% in Q1 2014, it appears very likely that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, now broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Accordingly, markets are expecting a first increase around the end of 2014.

1.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed in this quarter.

1.3 In June, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $35bn and are expected to stop by Q3 2014, providing strong economic growth continues this year. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rates since then look as if they are recovering well.

1.4 The Eurozone is facing an increasing threat from deflation. In May, the inflation rate fell further, to reach 0.5%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June to loosen monetary policy in order to promote growth.

2 Outlook for the next six months of 2014/15

2.1 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and the first quarter of 2014 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for the rest of 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy has been that wage inflation has been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during this year, especially if there is also a recovery in growth in labour productivity (leading to increases in pay rates). With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

2.2 As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

3 Capita's interest rate forecast

	Sep-14	**Dec-14**	**Mar-15**	**Jun-15**	**Sep-15**	**Dec-15**	**Mar-16**	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**	**Jun-17**
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.40%	4.40%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%

APPENDIX D

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.