Manchester City Council
Report for Information

Report To: Audit Committee – 9 June 2016

Subject: Treasury Management Annual Report 2015-16

Report of: City Treasurer

Purpose

To report the Treasury Management activities of the Council 2015-16.

Recommendations

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

Wards Affected:

Not Applicable

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to four years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2015-16 (Executive Committee 1st July 2015, Council 15th July 2015).

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 12th February 2014 as part of the Treasury Management Strategy Statement for 2015-16.

1.2 CIPFA amended the CIPFA Treasury Management in the Public Services Code of Practice in late 2011. The revised Code recommended 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 19th November 2015, 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 2016
Section 3: Borrowing Strategy for 2015-16
Section 4: Borrowing Activities in 2015-16
Section 5: Treasury Borrowing in 2015-16
Section 6: Compliance with Treasury Limits and Prudential Indicators
Section 7: Investment Strategy for 2015-16
Section 8: Temporary Borrowing and Investment Outturn for 2015-16
Section 9: Conclusion

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

2 The Council's Portfolio Position as at 31st March 2016

2.1 As outlined in the approved Treasury Management Strategy for 2015-16 it was anticipated that there would be a need to undertake some permanent borrowing in 2015-16 to fund the capital programme and to replace some of the internal funds. There was borrowing from the Government in the year from the Homes and Communities Agency (HCA) and for the Housing Investment Fund (HIF). Beyond this cash balances during the year have been relatively high and, as it remains the policy to keep cash low and minimise temporary investments, no other borrowing activity was undertaken during the year.

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

Loan Type	31 March 2015 Principal £m	31 March 2015 Average Rate %	31 March 2016 GF £m	31 March 2016 HRA £m	31 March 2016 Principal £m	31 March 2016 Average Rate %
PWLB	0.0	0.00	0.0	0.0	0.0	0.00
Temporary Borrowing *	8.0	0.50	7.3	0.0	7.3	0.50
Market Loans	491.2	4.52	408.7	71.5	480.2	4.71
Stock	8.1	3.37	8.1	0.0	8.1	3.37
Government Lending	11.8	0.00	28.6	0.0	28.6	0.00
Gross Total	**519.1**	**4.34**	**452.7**	**71.5**	**524.2**	**4.37**
Temporary Deposits	(103.8)	0.40	(180.3)	0.0	(180.3)	6.15
Internal Balances (GF/HRA)	0.00	0.0	34.0	(34.0)	0.00	0.00
Net Total	**415.3**		**306.4**	**37.5**	**343.9**	

2.3 In the table above HCA and HIF monies have been reclassified in 2015-16 from Market Loans to Government Lending to differentiate such financing from other Market Loans. At 31st March 2016 £17.5m had been advanced from the HCA and £11.1m for the HIF.

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 An assumed borrowing need of £150m was identified in the budget for 2015-16. Borrowing however, other than that from the HCA and for the HIF, became unnecessary in the year. This positive change is explained by favourable movements in the levels of receipts and payments together with the net £28.6m advances from the HCA and for the HIF.

2.6 Several local public sector organisations invest funds with the Council in order reduce counterparty risk and to achieve an investment return. Such facilities are not available to them through their banks. The Council has borrowed a further £7.3m in this way, which is deemed to be temporary borrowing due to the facility offered. At 31st March 2016 this comprised £1.1m from the Manchester International Festival, £6.1m from the Manchester Mortgage Corporation Ltd and £0.1m from the Manchester Federation of Schools.

3 Borrowing Strategy for 2015-16

3.1 The expectation for interest rates within the strategy for 2015-16 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. Investments were expected to 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 to reduce counterparty risk; and taking borrowing to 'lock-in' long term borrowing at historically low rates and to 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.

4 Borrowing Activities in 2015-16

Homes & Communities Agency (HCA)

4.1 During the year the HCA made funding available to the Council which is in effect, a 'loan' of the HCA's receipts from the disposal of its land and property within Greater Manchester (GM), as agreed in the GM City Deal. The funds can be used to invest in any project which supports GM City Deal objectives. Some of the funds will be passed on to other GM authorities for projects within their areas.

4.2 In the year the Council received a further £2.2m of this funding, whilst a £5m drawdown for one year received in February 2015 was repaid. There was also an advance of £8.5m from the HCA for the New Elm initiative. At 31st March 2016 the balance of the HCA loans was £17.5m. Further funds will be called down against these arrangements from 2016-17 onwards.

4.3 The funding from the HCA is held as an interest free loan, until such time as an investment approval is made. At this point, the approved element of the loan becomes risk-based, with the return to the HCA based on the performance of that investment.

4.4 The funds are to be used for housing or commercial projects within Greater Manchester and the location depends on where the HCA receipts originate from together with whether the receipt is due to the sale of residential or commercial property. Proceeds from commercial property are not borough-specific, whereas proceeds from residential property are. One of the key selection criteria in choosing the projects funded by this loan is the need for the project to demonstrate that it can repay the funds loaned to it.

4.5 HCA funds passed on by the Council to other authorities within Greater Manchester are treated as investments by the Council. Where monies are passed on to other local authorities, the terms of the agreement mirror those that the Council has agreed with the HCA.

4.6 The funds received are to be repaid to the HCA in March 2022. No interest is charged to the Council for the receipt of the funds, however, should an investment made with HCA funds not be recovered, the loss is deducted from the amount due to HCA. Conversely, should any profit be made by an investment these will be added to the amount due to the HCA.

4.7 This means the loan is almost risk-free to the Council, as the HCA suffer any losses on the investments made with the funding. As such, it is an extremely attractive form of funding, which can be used to benefit economic growth across the wider City Region.

Housing Investment Fund (HIF)

4.8 Funding for the HIF is similar to, but distinct from that associated with the HCA arrangements described above. Both finance streams are provided by the Department for Communities & Local Government (DCLG).

4.9 In the case of the HIF £300m in total is being made available to support house building initiatives across Greater Manchester. After funds are received the Council advances the finance as loans to Developers to assist building schemes. The Council holds the HIF advances as an interest free loan until such time as an investment approval is made.

4.10 The HIF funds are loans which are ultimately repayable by the Council to the DCLG. The loans the Council has received to 31st March 2016 are repayable in 2028.

4.11 When an investment approval is made the approved element of the loan becomes risk-based. Should a Developer default on repayment the DCLG will absorb the first 20% of any resulting losses. After this the balance of any remaining losses will be taken by the participating GM Local Authorities.

4.12 One of the key selection criteria in choosing the projects funded by this loan is the need for the project to demonstrate that it can repay the funds loaned to it.

4.13 In the year the Council received £11.1m of this funding which was recorded as a loan at 31st March 2016. Further HIF funding was received in the year, but the uncommitted amount at the year end was returned to the DCLG according to their instructions and will be called own again starting in 2016-17.

5 Treasury Borrowing in 2015-16

5.1 Public Works Loan Board (PWLB) interest rates have fluctuated during the year. Overall at the year end the rates were at levels comparable to those at the start of the 2015-16 financial year, as shown in the graph at Appendix A.

PWLB Borrowing Rates 2015-16 for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.21%	1.67%	2.30%	3.18%	3.01%
Date	23/03/2015	31/03/2015	10/04/2015	10/05/2015	29/06/2015
High	1.55%	2.55%	3.26%	3.86%	3.78%
Date	05/08/2015	13/08/2015	23/08/2015	22/09/2015	11/11/2015
Average	1.41%	2.20%	2.84%	3.54%	3.42%

5.2 The rates above reflect the standard PWLB rate. The Government after 1st November 2012, 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 has provided the required information and can therefore access this Certainty Rate.

5.3 The Council has agreed a £100m facility with the European Investment Bank (EIB) which will form part of the Council's future overall borrowing strategy. The EIB's rates for sterling borrowing continue to be favourable compared to PWLB, allowing for existing planned future borrowing from PWLB to be replaced by cheaper funding from the EIB. The latest expectation is that the facility will start to be drawn down in 2016-17 to 2018-19. The EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency. Any monies borrowed are part of the Council's overall pooled borrowing.

6 Compliance with Treasury Limits and Prudential Indicators

6.1 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.

6.2 In the year there were five breaches of the Barclays Call Account limit as follows:

Date		**Amount over £10m limit**	**Reason**
1	02/04/2015	£8.1m	Human error associated with transactions to transfer facilities from the existing Co-operative Bank to the new arrangements with Barclays Bank.
2	07/5/2015	£0.7m	Late unexpected receipt of £1.8m.

3	01/7/2015	£1.4m	Late unexpected receipt of £2.0m.
4	10/12/15	£1.4m	Late unexpected receipt of £5.3m.
5	11/03/2016	£0.4m	Late receipts was higher than originally forecast, as included fees.

6.3 Apart from the breach on the 2nd of April arising on the transfer of banking arrangements, each of the remaining breaches were caused by unexpected receipts. On each occasion the receipts were received late in the day with no opportunity to initiate further banking action to remain within the Call Account limit.

6.4 In the year there were also eight breaches of the daily +/- £250k limit on the Barclays Group Balance Account. These breaches were also mainly caused by unexpected receipts arriving late in the day leaving no opportunity to initiate further banking action to remain within limits.

6.5 For each of these breaches, both of the Barclays Call Account and of the Barclays Group Balance Account, the Treasurer was notified and action taken on the following working day to bring balances back within approved limits. Treasury Management also continue to take every opportunity to remind Council officers, external bodies and schools of the need to provide prior and accurate notification of their intended payments to the Council.

7 Investment Strategy for 2015-16

7.1 The Treasury Management Strategy Statement (TMSS) for 2015-16 was approved by the Finance Scrutiny Committee on 12th March 2015. A revised version was approved by Council on 15th July 2015.

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.

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

- 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.

7.3 The Council's temporary cash balances are managed by the Council Treasurer in-house and invested with those institutions listed in the Council's Approved Lending List. Officers can confirm these institutions meet the security criteria set out in the Annual Investment Strategy.

7.4 New European banking legislation is being introduced and is expected to be implemented in 2018. This is in response to the banking crisis when in the UK the Government used taxpayer funds to support banks in danger of failing. In future
'bail-in' will be applied in such a scenario which will mean after shareholders' equity, depositors' funds will be used to support a bank at risk. The legislation will increase the risk to the Council of holding cash deposits with banks and building societies.

7.5 In view of this new bail-in risk other investment options are being investigated. These include the purchase of treasury bills from Government, often referred to as 'Gilts'. The purchase of treasury bills offers the same security as depositing funds with the Government's Debt Management Office, (DMO) albeit they can (dependent on market conditions) provide the benefit of higher interest rates. In order to trade in treasury bills the Council will require a custodian facility. The custodian is usually a bank who holds the bills on the investor's behalf.

7.6 There are a number of custodian options available which have varying fee structures. These are being appraised together with the implications for the Council's existing daily treasury management operations and procedures.

7.7 To provide further protection from bail-in risk the Council is also investigating other forms of secured investments with banks. Although the Council's approved 2015-16 maximum thresholds for investments with banks and building societies remain unchanged, in the second half of the year and for the future the Council is working to revised operating limits for bank deposits to reduce bail-in risk. The limits on bank deposits have been reduced in the range 50-100%, with the exception of the £10m limit with Barclays bank, because Barclays is the Council's main banker and is the investment destination of last resort for the close of daily trading.

8 Temporary Borrowing and Investment Outturn 2015-16

8.1 Investment rates available in the market continue to be at an historic low point. The average level of funds available for investment purposes in 2015-16 was just over £159m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, the receipt of grants, and progress on the capital programme.

8.2 The average level of temporary borrowing during the financial year, excluding those days when no temporary borrowing was required, was £7.8m.

8.3 Detailed below is the temporary investment and borrowing undertaken by the Council. As illustrated, the authority underperformed the benchmark by 2 basis points on investments due to the inter local authority market being relatively depressed.

8.4 The local authority market responds to supply and demand pressures. It has been less buoyant in the year due to the amount of cash available in the system. This reflects that in many cases local authorities' receipts have been front loaded in the year and not that they have benefitted from higher income levels.

8.5 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 marginally above the benchmark cost.

	Average temporary Investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£159.3m	0.34%	0.36%
Temporary Borrowing	£7.8m	0.50%	0.49%

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

8.6 None of the institutions in which investments were made showed 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.

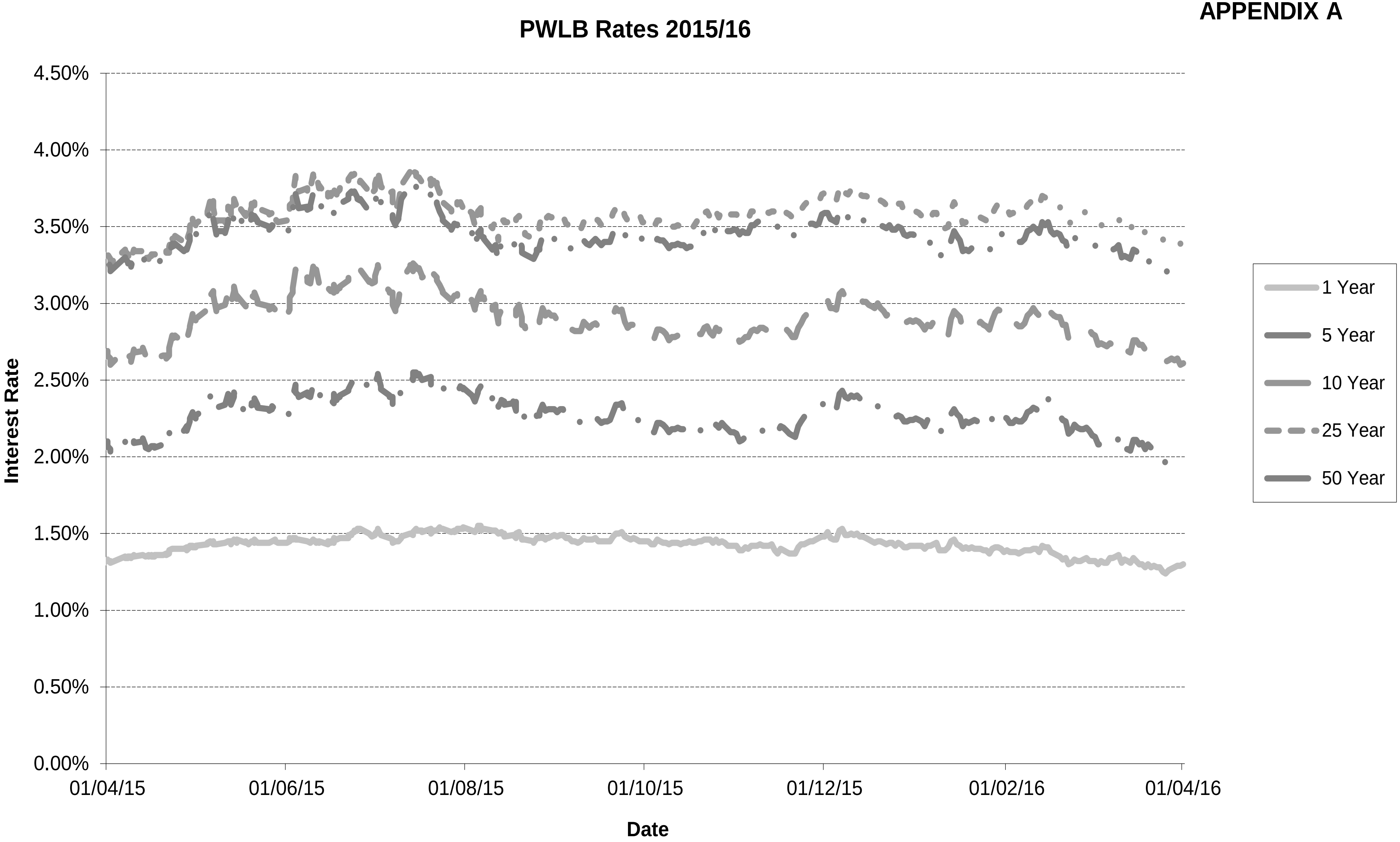
9 Conclusion

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 (sourced from reserves, provisions, positive cash flows, etc). As cash balances have been relatively high, and it remains the Council's policy to keep cash as low as possible and not to borrow in advance of need for capital purposes, no long term borrowing has been taken during the 2015-16 financial year.

9.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.34%, which is slightly lower than the benchmark average 7-day LIBID rate of 0.36%. There was an average net cost of temporary borrowing of 0.50%, slightly above the benchmark average 7-day LIBOR rate of 0.49%.

9.3 Consideration will be given to borrowing during the 2016-17 financial year. This will be dependent on the interest rates available and the need to borrow to meet the Council's cash needs. All available options will be considered.

APPENDIX A


PWLB Rates 2015/16
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
Interest Rate
01/04/15
01/06/15
01/08/15
01/10/15
01/12/15
01/02/16
01/04/16
Date
1 Year
5 Year
10 Year
25 Year
50 Year

Appendix B

Treasury Management Prudential Indicators: 2015-16

	Original	**Minimum In Year to 31 Mar 2016**	**Maximum In Year to 31 Mar 2016**
	£m	**£m**	**£m**
Operational Boundary for External Debt:			
Borrowing	929.6	508.7	549.4
Other Long Term Liabilities	216.0	144.6	144.6
Authorised Limit for External Debt:			
Borrowing	1,356.7	508.7	549.4
Other Long Term Liabilities	216.0	144.6	144.6
		Actual as at 31 Mar 2016	
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	91%	59%	
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	88%	41%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit** 2015-16 Original	**Upper Limit** 2015-16 Original	**Actual as at 31 Mar 2016**
under 12 months	0%	60%	0%
12 months and within 24 months	0%	100%	35%
24 months and within 5 years	0%	70%	60%
5 years and within 10 years	0%	60%	1%
10 years and above	0%	60%	4%

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.