Manchester City Council
Report for Information

Report to: **Audit Committee – 11 June 2017**

Subject: **Treasury Management Annual Report 2017/18**

Report of: **City Treasurer**

Summary

To report the Treasury Management activities of the Council 2017/18.

Recommendation

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

Wards Affected: None

Contact Officers:

Name: Carol Culley
Position: City Treasurer
Telephone: Tel. 0161 234 3406
Email: c.culley@manchester.gov.uk

Name: Janice Gotts
Position: Deputy City Treasurer
Telephone: 0161 234 3590
Email: j.gotts@manchester.gov.uk

Name: Tim Seagrave
Position: Group Finance Lead - Capital & Treasury Management
Telephone: 0161 234 3445
Email: t.seagrave@manchester.gov.uk

Name: David Williams
Position: Treasury Manager
Telephone: 0161 234 8493
Email: d.williams8@manchester.gov.uk

Background documents (available for public inspection):

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2017-18 (Executive - 8 February 2017, Resource and Governance Scrutiny Committee - 20 February 2017, Council - 3 March 2017).

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 3rd March 2017 as part of the Treasury Management Strategy Statement for 2017/18.

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 30th November 2017, 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 In December 2017 following a CIPFA consultation the Prudential Code and Indicators were further revised, however at the date of this Report implementation guidance is awaited from CIPFA.

1.5 This outturn report covers:

Section 1: Introduction and Background
Section 2: The Council’s Portfolio Position as at 31st March 2018
Section 3: Borrowing Strategy for 2017/18
Section 4: Borrowing Activities in 2017/18
Section 5: Government Lending
Section 6: Treasury Borrowing in 2017/18
Section 7: Compliance with Treasury Limits and Prudential Indicators
Section 8: Investment Strategy for 2017/18
Section 9: Temporary Borrowing and Investment Outturn for 2017/18
Section 10: 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 31 March 2018

2.1 As outlined in the approved Treasury Management Strategy for 2017/18 it was anticipated that there would be a need to undertake some permanent borrowing in 2017/18 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:

	31 March 2017		31 March 2018			
Loan Type	Principal	Average Rate	GF	HRA	Principal	Average Rate
	£m	%	£m	£m	£m	%
PWLB	0.0	0.00	0.0	0.0	0.0	0.00
Temporary Borrowing	2.4	0.33	0.9	0.0	0.9	0.50
Market Loans	458.2	4.81	378.5	69.7	448.2	4.75
Stock	7.4	3.34	0.9	0.0	0.9	4.00
Government Lending	68.0	0.00	80.3	0.0	80.3	0.00
Gross Total	**536.0**	**4.16**	**460.6**	**69.7**	**530.3**	**4.02**
Temporary Deposits	(83.7)	(0.18)	(137.9)	0.0	(137.9)	(0.35)
Internal Balances (GF/HRA)	0.0	0.00	37.0	(37.0)	0.00	0.00
	(83.7)					
Net Total	**452.3**		**359.7**	**32.7**	**392.4**	

2.3 Long term borrowing of £10m matured in the year and was repaid.

2.4 At 31st March 2018 Government lending comprised £33.7m for the HCA, £42.7m for the HIF and £3.9m for Salix.

2.5 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.

2.6 An assumed borrowing need of £401m was identified in the budget for 2017/18. Borrowing however, other than Government lending for the HCA, HIF and Salix became unnecessary in the year. This positive change is explained by favourable movements in the levels of receipts and payments together with the net £80.3m total advances from the HCA, HIF and Salix.

2.7 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 £0.9m in this way, which is deemed to be temporary borrowing due to the facility offered. At 31st March 2018 this comprised £0.7m from the Manchester International Festival, £0.1m from the Manchester Mortgage Corporation Ltd and £0.1m from the Manchester Federation of Schools.

2.8 The value of stock has changed in the year following an exercise to redeem the historical stock holding. By the year end £6.5m of stock had been redeemed. Redemption of the Council's stock was approved by the Audit Committee on the 1st December 2016. The Council's recent positive cash flow afforded an opportunity to redeem the long standing stock holding which dates back to 1874 and 1891. Redemption has the benefit of removing the annual payment of interest and will increase staff capacity by avoiding the considerable overhead involved in administering the stock.

3 Borrowing Strategy for 2017/18

3.1 The expectation for interest rates within the 2017/18 strategy was informed by the Council's external Treasury Advisors. Link Asset Services expected Bank Rate to remain unchanged at 0.25% until a first increase to 0.50% in quarter 2, 2019 with a rise to 0.75% by March 2020. The Bank of England actually increased Bank Rate to 0.50% from 0.25% on the 2nd November 2017. This action reinstated Bank Rate to its previous level prior to the reduction to 0.25% on the 3rd of August 2016. Despite the rise in Bank Rate the assumption that variable or short-term rates were expected to be the cheaper form of borrowing over the period remained valid. 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.

4 Borrowing Activities in 2017/18

4.1 There was no external borrowing during the year, despite an assumed borrowing need of £401m being identified in the budget for 2017/18. Borrowing became unnecessary in the year because of favourable movements in the levels of receipts and payments. However, there was additional interest free borrowing from the Government of £12.3m in respect of new advances from the HCA, the HIF and Salix.

5 Government Lending - Homes & Communities Agency (HCA) and the Housing Investment Fund (HIF)

5.1 The HCA has made funding available to Greater Manchester (GM), which is in effect a 'loan' of the HCA's receipts from the disposal of its land and property within GM. 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 GM authorities for projects within their areas. The funds received are classified as loans as they will be repaid to the HCA in March 2022, however no interest is charged by the HCA on the advances.

5.2 The HCA is also providing £300m funding in total to GM for housing investment in respect of the HIF. Funding for the HIF is similar to, but distinct from that for the HCA arrangements. The HIF advances are also treated as loans as they are ultimately repayable to the DCLG in 2028, and are interest free. Any losses resulting from investment of HIF funds will be met by Government (up to 20%), or by guarantee from the ten Greater Manchester authorities (including Manchester).

5.3 The HIF and HCA are Greater Manchester initiatives which will be operated by the Greater Manchester Combined Authority (GMCA). Currently GMCA are waiting to be granted the statutory powers to operate the initiatives, therefore in the interim Manchester City Council are acting as the responsible body for the HIF and HCA.

5.4 When the initiatives are transferred to GMCA, there will be no implications for the Council other than the cancellation of its Government lending, together with a reduction in the amount of temporary surplus cash. The latter will impact on income generated from short term deposits and the Council's capacity to internally borrow.

Homes & Communities Agency (HCA)

5.5 In the year the Council received a further £7.5m of HCA funding. Further funds will be called down against these arrangements from 2018/19 onwards. 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.

5.6 The funds are to be used for housing or commercial projects within Greater Manchester. HCA funds passed on by the Council to other authorities within Greater Manchester are treated as investments by the Council.

5.7 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. This means the loan is almost risk-free to the Council.

Housing Investment Funding (HIF)

5.8 In the year the Council received a further £0.9m of this funding which was recorded as a loan at 31st March 2018. 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 2018/19.

Salix Borrowing

5.9 In the year the Council received £3.9m of this funding which was recorded as a loan at 31st March 2018. Salix Finance Ltd. provides interest-free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The advance was received in respect of specific Council projects and will be repaid by 1st April 2023.

6 Treasury Borrowing in 2017/18

6.1 PWLB interest rates have fluctuated during the year. Overall at the year end the rates were around 0.6% higher than those at the start of the 2017/18 financial year for borrowing up to 5 years, 0.3% higher for borrowing up to 10 years and 0.1% lower for borrowing over 25 years as shown in the graph at Appendix A.

PWLB Borrowing Rates 2017/18 for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.00%	1.34%	1.98%	2.72%	2.45%
Date	03/05/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017
High	1.71%	2.21%	2.73%	3.13%	2.84%
Date	21/03/2018	15/02/2018	15/02/2018	15/02/2018	15/02/2018
Average	1.13%	1.70%	2.28%	2.89%	2.61%

6.2 After 1st November 2012 the Government, 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 this Certainty Rate.

6.3 The Government previously made a PWLB 'Project Rate' available for one strategic priority project identified in each of the Local Enterprise Partnerships (LEPs). The project rate was 0.40% below the standard PWLB rate. The Project Rate has now been superseded by a 'Local Infrastructure Rate'. This operates on similar principles and offers a rate 0.40% below the standard PWLB rate for nominated high value for money infrastructure projects.

6.4 During 2017/18 the Council accepted an offer from Barclays to reclassify two range LOBO loans each of £30m which have maturity dates in 2077. The action removed all of the loan options and converted the borrowing to standard long term debt. The revised interest rate reflected the expected forecast economic value of the removed options to the Council. Barclays bore the cost of removing the lender option and change to a fixed rate basis. Barclays' motive for the change was that it provided an accounting benefit for the bank. The change was also advantageous to the Council as it increases long term certainty by the removal of options from the loan portfolio.

6.5 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, and has been able to extend the drawdown date for it. 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 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.

7 Compliance with Treasury Limits and Prudential Indicators

7.1 During the financial year, the Council operated within the treasury limits and prudential indicators set out in the Treasury Management Strategy Statement. This is with the exception of seven breaches of the daily current account which are described below. Performance against the treasury targets is shown in Appendix B.

7.2 In the year there were seven breaches of the daily £400k limit on the Barclays current account. The causes of the breaches can be classified into three categories:

i On one occasion Barclays had issues with their on-line system meaning Treasury Management staff were unable to obtain information on balances and therefore arrange transfers to maintain accounts within limits.

ii A receipt did not arrive on one occasion that Treasury Management staff had previously been advised was due, resulting in the current account being overdrawn.

iii On five occasions there were late receipts that Treasury Management staff had not been previously advised of. These resulted in the current account being above the £400k limit. Each occurrence was late in the day meaning there was no opportunity to transfer funds to the Call Account to remain within limits.

7.3 Each breach was notified to the Treasurer and action taken on the following working day to bring balances back within approved limits.

8 Investment Strategy for 2017/18

8.1 The Treasury Management Strategy Statement (TMSS) for 2017/18 was approved by the Executive Committee on 8th February 2017, and by Council on 3rd March 2017. 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.

8.2 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.

8.3 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.

9 Temporary Borrowing and Investment Outturn 2017/18

9.1 Investment rates available in the market continue to be at an historic low point. The average level of funds available for investment purposes in 2017/18 was just over £294m. 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, progress on the capital programme, and working capital.

9.2 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 as noted in the table at 9.4.

9.3 The average level of temporary borrowing during the financial year, excluding those days when no temporary borrowing was required, was £1.7m.

9.4 Detailed below is the temporary investment and borrowing undertaken by the Council. As illustrated, the Council over performed the benchmark by 2 basis points on investments due to the inter Local Authority market being relatively buoyant.

	Average temporary Investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£294.3m	0.23%	0.21%
Temporary Borrowing	£1.7m	0.33%	0.33%

**Average 7-day LIBID / LIBOR rate sourced from Link Asset Services*

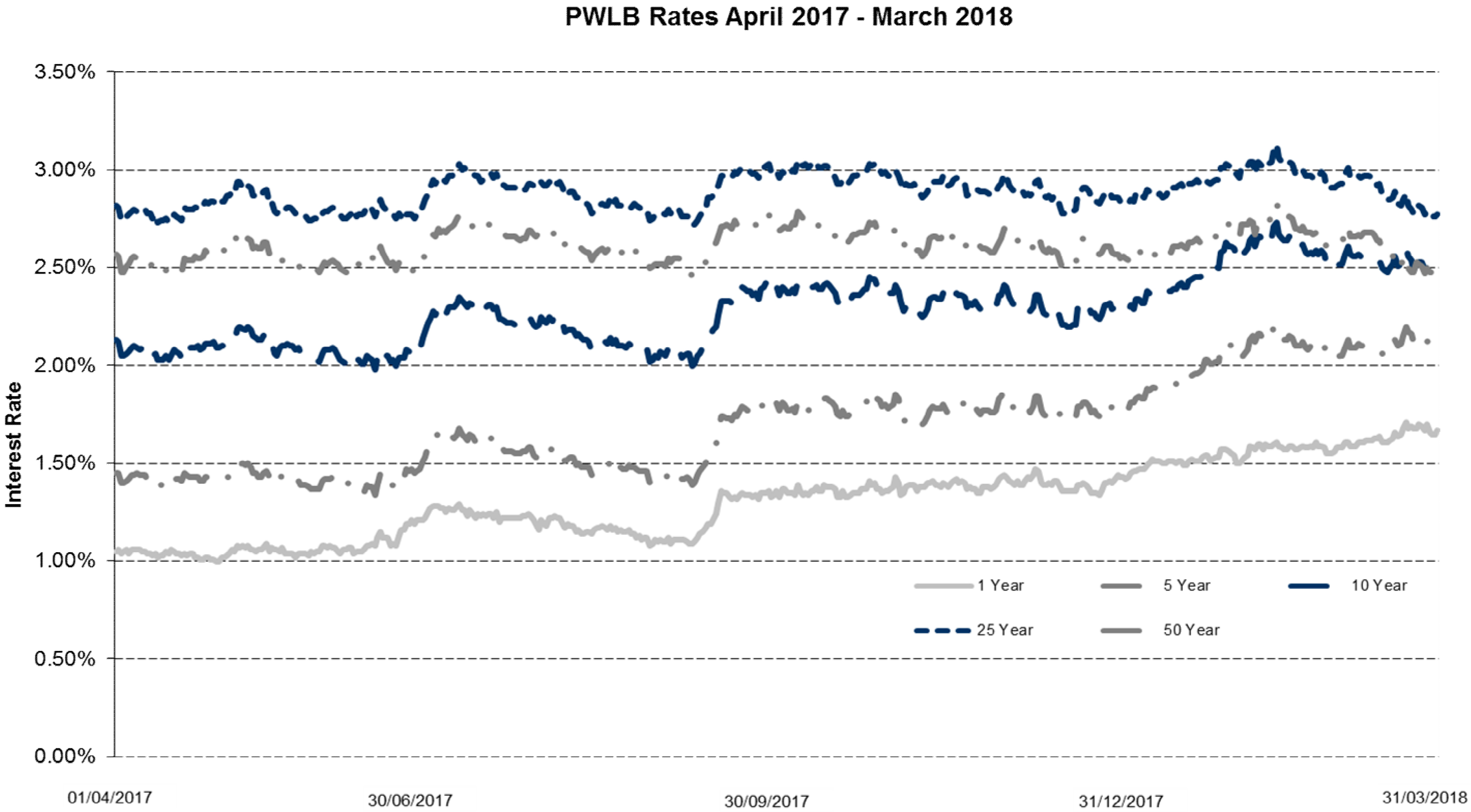
9.5 None of the institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year. The list of institutions in which the Council invests is kept under continuous review.

10 Conclusion

10.1 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.). It remains the Council's policy to keep cash as low as possible and not to borrow in advance of need for capital purposes. As cash balances have been relatively high, no long term borrowing has been taken during the 2017/18 financial year.

10.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.23%, which is slightly higher than the benchmark average 7-day LIBID rate of 0.21%. There was an average net cost of temporary borrowing of 0.33%, equal to the benchmark average 7-day LIBOR rate of 0.33%.

10.3 Consideration will be given to borrowing during the 2018/19 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.


PWLB Rates April 2017 - March 2018
Interest Rate
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
01/04/2017
30/06/2017
30/09/2017
31/12/2017
31/03/2018
1 Year
5 Year
10 Year
25 Year
50 Year

Appendix B

Treasury Management Prudential Indicators: 2017/18

	Original £m	Minimum In Year to 31 Mar 2018 £m	Maximum In Year to 31 Mar 2018 £m
Operational Boundary for External Debt:			
Borrowing	1,159.8	529.0	647.6
Other Long Term Liabilities	216.0	156.4	156.4
Authorised Limit for External Debt:			
Borrowing	1,555.4	529.0	647.6
Other Long Term Liabilities	216.0	156.4	156.4
		Actual as at 31 Mar 2018	
The Council 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	96%	59%	88%
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	92%	12%	41%
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit** **2017/18 Original**	**Upper Limit** **2017/18 Original**	**Actual as at 31 Mar 2018**
under 12 months	0%	70%	0%
12 months and within 24 months	0%	100%	43%
24 months and within 5 years	0%	80%	33%
5 years and within 10 years	0%	70%	0%
10 years and above	0%	70%	24%

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.