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MANCHESTER
CITY COUNCIL

Audit Committee

Date: Monday, 5 November 2018
Time: 10.00 am
Venue: Council Chamber, Level 2, Town Hall Extension, Manchester

Everyone is welcome to attend this committee meeting.

This is a supplementary agenda containing additional information about the business of the meeting that was not available when the agenda was published

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Membership of the Audit Committee

Councillors - Ahmed Ali (Chair), Connolly, Lanchbury, Russell, A Simcock and Watson

Independent Co-opted Members – Mr S Downs and Dr D Barker

Agenda

Further Information

For help, advice and information about this meeting please contact the Committee Officer:

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This agenda was issued on **Tuesday, 30 October 2018** by the Governance and Scrutiny Support Unit, Manchester City Council, Level 3, Town Hall Extension (Mount Street Elevation), Manchester M60 2LA.

Manchester City Council
Report for Information

Report to: Audit Committee – 5 November 2018

Subject: Treasury Management Interim Report 2018-19

Report of: City Treasurer

Summary

To report the Treasury Management activities of the Council during the first six months of 2018-19.

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):

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2018-19

(Executive – 7 February 2018, Resource and Governance Scrutiny Committee – 19 February 2018, Council – 2 March 2018)

1 Introduction and Background

1.1 Treasury Management in Local Government is regulated by the Chartered Institute of Public Finance and Accountancy (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.

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 (TMSS), the requirement to report to members at least twice a year on the activities of the Treasury Management function. The recommendation was first included within the 2010-11 TMSS approved by the Executive on the 10th February 2010. The requirement has also been included and approved as part of each the annual TMSS since 2010-11. 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. There were further changes made to the Code in 2017 which are described in Section 9 below.

Section 1: Introduction and Background
Section 2: The Council's Portfolio Position as at 30th September 2018
Section 3: Review of Economic Conditions
Section 4: External borrowing in 2018-19 to date
Section 5: Compliance with Treasury Limits and Prudential Indicators
Section 6: Investment Strategy for 2018-19 to date
Section 7: Temporary Borrowing and Investment for 2018-19 to date
Section 8: Changes to the CIPFA Prudential and Treasury Management Codes
Section 9: Conclusion

Appendix 1: Public Works Loans Board (PWLB) Interest Rates
Appendix 2: Treasury Management Prudential Indicators
Appendix 3: Review of Economic Conditions, provided by advisors
Appendix 4: Glossary of Terms

Portfolio Position as at 30th September 2018

2.1 As outlined in the approved Treasury Management Strategy for 2018-19 it was anticipated that there would be a need to undertake some permanent borrowing in 2018-19 to fund the capital programme and to replace some of the internal funds. Cash balances during the year to date have been relatively high and no borrowing has been required during the first half of the year. However borrowing is likely to be required during the second half of the year.

2.2 The need for some external borrowing will be required to facilitate the transfer of balances to the Greater Manchester Combined Authority (GMCA) for initiatives the Council has been operating on GMCA's behalf. These matters are discussed in detail below.

2.3 The Council's debt position at the beginning of the financial year and at the end of September 2018 for comparison was as follows:

Loan Type	31-Mar-18 Principal	Average Rate	30-Sep-18 Principal	Average Rate
	£m	*%*	*£m*	*%*
PWLB	0.0	0.00	0	0.00
Temporary Borrowing	0.9	0.50	4.0	0.59
Market Loans	448.2	4.75	448.2	4.75
Stock	0.9	4.00	0.9	4.00
Government Funding	80.3	0.00	164.5	0.00
Gross Total	**530.3**	4.02	**617.6**	3.46
Temporary Deposits	-137.9	0.35	-121.0	0.49
Net Total	**392.4**		**496.6**	

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 Total debt increased by £87.3m during the period 31st March 2018 to 30th September 2018. The increase was mainly due to the receipt of £80.6m in further advances from the MHCLG for the Housing Investment Fund (HIF) and £3.6m in respect of the receipt of the second of three SALIX loans. For accounting purposes the HIF and SALIX advances are treated as central government borrowing. The final £3.6m element of the SALIX loan is expected on the 29th March 2019. The funds the Council holds for Manchester organisations that work closely with the Council are classed as temporary borrowing and increased by £3.1m during the period.

2.6 An assumed borrowing need of £360m was identified in the budget for 2018-19 and based on the current cashflow forecast the estimated borrowing requirement by 31 March 2019 is £280m. This includes an assumption that an estimated £68.7m for the HIF will transfer to GMCA before the next financial year end. The Council has operated the HIF on GMCA's behalf whilst the Combined Authority has awaited the statutory powers it requires to operate the Fund itself. GMCA have now been granted the necessary statutory powers and arrangements for the transfer are being confirmed.

2.7 It is anticipated, based on the forecast cash flow, that the level of temporary deposits will continue to fall and that therefore the Council will need to borrow further funding during 2018/19. As discussed below, the Council continues to be in discussions with the European Investment Bank, and is evaluating other opportunities in the market. If any borrowing is taken during it will be reported at outturn.

3. Review of Economic Conditions: April to date 2018

3.1 In August the Bank of England raised the key lending rate by 0.25% to 0.75%. This was the first change in rate since it was increased to 0.50% in November 2017. The concerns expressed in our 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 Appendix 3 provides a more detailed review of the economic situation.

4. Treasury Borrowing in 2018-19 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 1.

PWLB Borrowing Rates 2018-19 to date for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.48%	1.87%	2.29%	2.70%	2.45%
Date	01/06/2018	29/05/2018	20/07/2018	20/07/2018	29/05/2018
High	1.77%	2.19%	2.63%	3.03%	2.84%
Date	19/09/2018	25/09/2018	25/04/2018	25/09/2018	25/09/2018
Average	1.66%	2.04%	2.45%	2.84%	2.61%

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 Council has discussed 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. Whilst the EIB appraises its funding plans against individual schemes, particularly around growth, employment and energy efficiency, any monies borrowed are part of the Council's overall pooled borrowing. There has not been any advice from the EIB that post Brexit these arrangements will change.

4.4 As part of the procedure to confirm the borrowing from the EIB the Council gained the bank's approval for six projects which meet the EIB lending criteria.

The initial forecast expenditure for these projects was sufficient to provide a basis for the EIB advance. The six projects are now much further developed and the budgets and phasing agreed. The latest estimates of expenditure are different to the initial outline figures and the basis these projects provide for the EIB borrowing requirement has been revised. It is expected these projects will now only provide a basis for £48.8m of EIB borrowing.

4.5 In view of this the Council has identified six additional projects which it believes meet the EIB criteria and these projects will provide a basis for a further £28.0m of borrowing. This together with the £48.8m in respect of the original projects will provide a basis for total EIB borrowing of £76.8m.

4.6 The EIB facility expired on the 8th September 2018 and the Council prior to this advised the EIB that the forecast spend for the six original projects approved as a base for the borrowing had reduced. At the same time the Council forwarded details of the additional projects. A decision from the EIB is currently awaited.

5 Compliance with Treasury Limits and Prudential Indicators

5.1 During the first half of the financial year, the Council operated within the Treasury Limits and the Prudential Indicators set out in the Treasury Management Strategy Statement. This is with the exception of three breaches of the daily current account limit which are described below. Performance against the Prudential Indicators is shown in Appendix 2.

5.2 During the period 1st April to 30th September 2018 there were three breaches of the daily £0-400k limit on the Barclays current account. One breach arose following the late receipt of £830k in respect of a legal completion which had not been advised to Treasury Management. The two other breaches were due to transfers to the Barclays Call Account being incorrectly actioned. Operating procedures have since been strengthened to avoid future repetition of this type of error.

6 Investment Strategy for 2018-19 to date

6.1 The Treasury Management Strategy Statement (TMSS) for 2018-19 was approved by Executive on 7th February 2018. 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 light of credit rating changes the Council needed to spread its counterparty risk by identifying more counterparties that can be utilised for investments; therefore included in the 2018-19 Treasury Management Strategy are a number of measures to broaden the basis of lending:

- Utilise UK banks / building societies and local authorities.

- Utilise non-UK banks / building societies in countries with an AAA rating.
- Diversify the investment portfolio into more secure UK Government and Government-backed investment instruments such as Treasury Bills.
- Utilise Certificates of Deposit and Covered Bonds with high quality counterparties, i.e. those that are AAA rated.
- Utilise Money Market Funds which are Constant Net Asset Value (CNAV) or Low Volatility Net Asset Value (LVNAV) and are AAA rated.
- Although the current investment strategy allows investments for up to 364 days, restrict deposits to less than 3 months unless the case can be made for investing for longer (i.e. to match a future commitment) apart from deposits with other Local Authorities or the Debt Management Office (DMO).

6.3 These measures were approved as part of the 2018-19 Strategy. It was noted in the 2018-19 Treasury Management Strategy Statement (TMSS) that bail-in risk was an issue. The TMSS contained measures to support the Council limiting this risk. The Council has:

- Opened Account and custodian facilities for trading in Treasury Bills. The intention is to bid in the weekly HM Treasury auction at times when the Council has temporary surplus cash and when Treasury Bill returns have improved compared to their current rates.
- Money Market Funds avoid bail-in risk and the Council has opened accounts with four Funds; Aberdeen, Aviva, Blackrock and Federated. Each of these Funds meet the requirements noted above with regard to credit rating and liquidity requirements.

6.4 The current strategy means that a significant proportion of the Council's investments are with the Government (via the Debt Management Office, DMO) or with other Local Authorities. This highlights the relatively low rate of credit risk that the Council takes when investing.

6.5 It should be noted that, whilst seeking to broaden the investment base, officers will continue to seek high quality investments. to limit the level of risk taken by the Council. It is not expected that the measures considered above will have a significant impact on the rates of return the Council currently achieves.

6.6 During the financial year to date the Council's temporary cash balances were managed by the City 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 Temporary Borrowing and Investment 2018-19 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 2018-19 was £160m. 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.

7.2 The temporary investment and borrowing undertaken by the Council is detailed below. As illustrated, the Council over performed the benchmark by 5 basis points on investments due to the inter local authority market being relatively buoyant.

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.

	Average temporary investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£159.8m	0.49%	0.44%
Temporary Borrowing	£3.3m	0.59%	0.56%

** Average 7-day LIBID/LIBOR rates*

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

8 Changes to the CIPFA Prudential and Treasury Management Codes

8.1 The first version of the CIPFA Treasury Management Code in the Public Services was published in 2001 and provides a framework for effective treasury management in public sector organisations. The Code was last updated in 2011 and further revision was proposed in 2017 in response to a sustained period of reduced public spending and development of the localism agenda.

8.2 On 10 November 2017 DCLG (now MHCLG) published a consultation on changes to the guidance on local authority investments and Minimum Revenue Provision (MRP). The consultation closed on 22nd December. The prudential framework under the Local Government Act 2003 incorporates four statutory codes; the Prudential Code and the Treasury Management Code which are prepared by CIPFA, and were updated in December 2017. The government consultation also covered changes to the Statutory Guidance on Local Authority Investments and the Statutory Guidance on MRP.

8.3 MHCLG has now published a summary of the responses to the consultation together with a final version of the two statutory guidance documents. The changes include:

i A new principle requiring local authorities to disclose the contribution that non-core investments make towards their service delivery objectives and/or placemaking role.

ii A new requirement to include quantitative indicators that will allow assessment of risk exposure.

iii Extension of the principles of prioritising security and liquidity over yield to cover non-financial assets, although local authorities are permitted to determine the relative importance of security, liquidity and yield for different types of investment and can assess liquidity of non-financial assets on a portfolio basis.

iv A requirement for local authorities to disclose their dependence on commercial income to deliver statutory services and the amount of borrowing that has been committed to generate that income.

v A requirement for additional disclosure by local authorities who borrow solely to invest in revenue generating investments. The guidance makes clear that borrowing in advance of need solely to generate a profit is not prudential, and local authorities will need to explain why they have chosen to disregard the statutory guidance.

vi Extension of the requirements regarding knowledge and expertise to cover other key individuals in the decision making process.

vii A change to the definition of 'prudent provision' to one that requires local authorities to set MRP in a way that covers the gap between the capital financing requirement and the amount of that requirement that is funded by income, grants and receipts.

viii Clarification that a charge to a revenue account for MRP should not be a negative charge (i.e. a credit).

ix Clarification of the approach to be adopted when changing the methodologies used to calculate MRP, to make it clear that an overpayment cannot be calculated retrospectively.

x Introduction of a maximum useful economic life of 50 years for calculating MRP, although local authorities can exceed this where there is related PFI debt with a longer term, or where the local authority has an opinion from a qualified person that the asset will deliver benefits for more than 50 years.

8.4 The revised Guidance on Local Government Investments applies from 1 April 2018. By the time of the confirmation of these changes many local authorities had already finalised their strategies and budgets and presented them to Council for approval. In view of this those Authorities that would face significant challenges in preparing the disclosures required by the guidance are allowed to defer inclusion of the revised disclosures to the first strategy presented after 1 April 2018. Implementation of the revised Guidance on Minimum Revenue Provision is deferred to 2019-20, however MHCLG is encouraging early adoption.

8.5 The City Treasurer in conjunction with the Treasury Management Team is actively reviewing the Council's Treasury Management and Capital strategies to determine how these may be improved to ensure they are fit for purpose and comply with the new arrangements. The Council's arrangements will be confirmed in the Treasury Management Strategy Statement for 2019-20.

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.) The Council's policy remains to keep cash as low as possible and not to borrow in advance of need for capital purposes. Cash balances have been relatively high during the first half of the year however a borrowing requirement is expected during the second half of 2018-19.

9.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.49%, in excess of the benchmark average 7-day LIBID rate of 0.44% and also 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.

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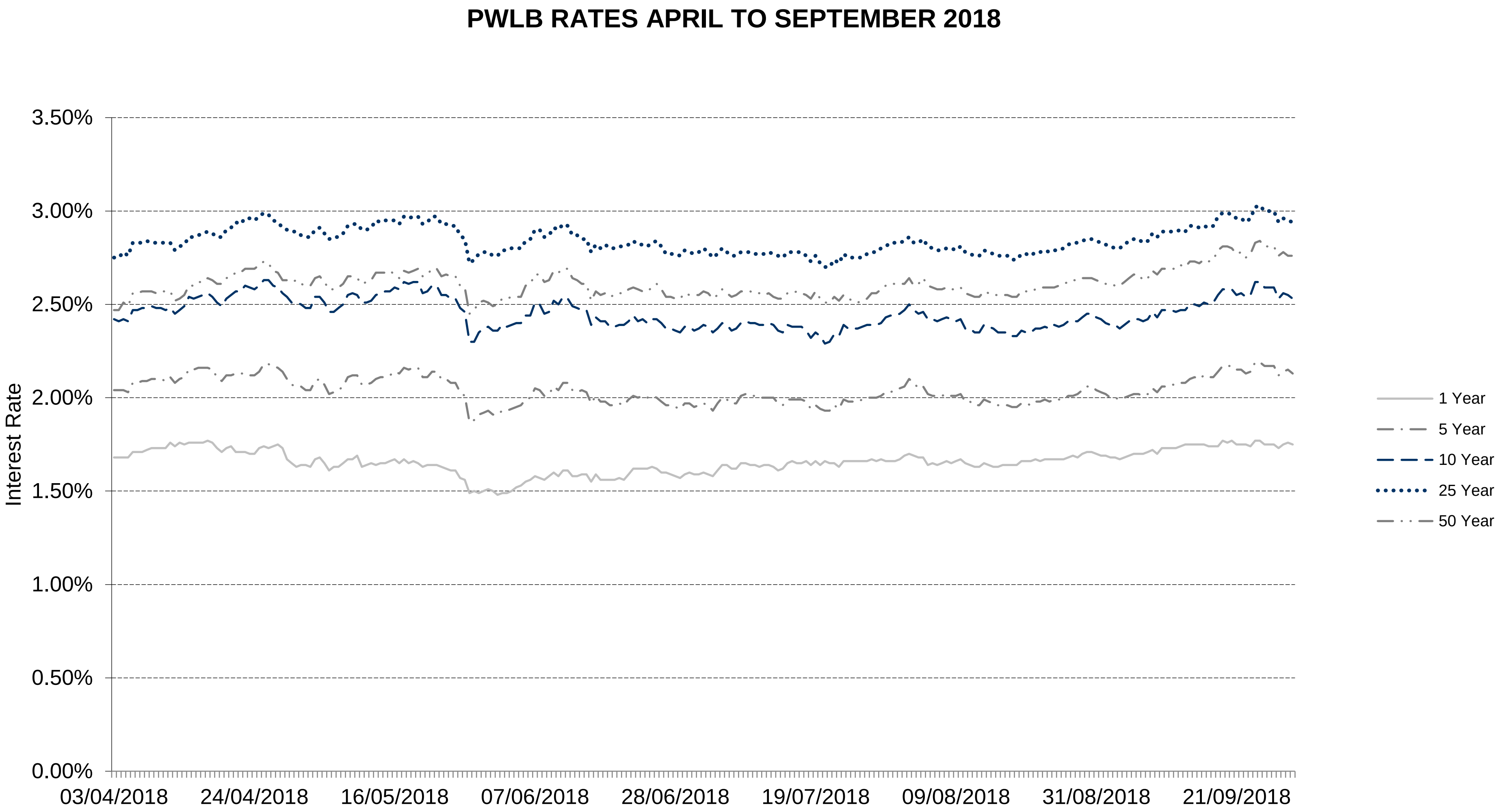
PWLB RATES APRIL TO SEPTEMBER 2018
Interest Rate
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
03/04/2018
24/04/2018
16/05/2018
07/06/2018
28/06/2018
19/07/2018
09/08/2018
31/08/2018
21/09/2018
1 Year
5 Year
10 Year
25 Year
50 Year

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Treasury Management Prudential Indicators: 2018-19 to date

	Original *£m*	Minimum In Year to 30 Sept 2018 *£m*	Maximum In Year to 30 Sept 2018 *£m*
Operational Boundary for External Debt:			
Borrowing	1,146.7	530.3	642.4
Other Long Term Liabilities	216.0	161.4	161.4
Authorised Limit for External Debt:			
Borrowing	1,454.8	530.3	642.4
Other Long Term Liabilities	216.0	161.4	161.4
		Actual as at 30 Sept 2018	
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	100%	51%	
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	85%	49%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit 2018-19 Original**	**Upper Limit 2018-19 Original**	**Actual as at 30 Sept 2018**
under 12 months	0%	70%	0%
12 months and within 24 months	0%	100%	52%
24 months and within 5 years	0%	80%	21%
5 years and within 10 years	0%	70%	3%
10 years and above	20%	80%	24

REVIEW OF ECONOMIC CONDITIONS FROM APRIL TO SEPTEMBER 2018 AND FUTURE OUTLOOK

This section has been prepared by the Council's Treasury Advisors, Link Asset Services, and includes their forecast for future interest rates.

1 ECONOMIC PERFORMANCE TO DATE 2018/19

1.1 The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will record no more than 1.5% for 2018, the Bank of England's Quarterly Inflation Report, also released in August, suggests that growth will pick up to 1.8% in 2019, albeit there are several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

1.2 In particular, some Monetary Policy Committee (MPC) members have expressed concerns about inflation threatening price stability (a similar theme to this time last year), particularly with the £ weak against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation is currently running at 2.5% but is expected to fall back towards the 2% inflation target over the next two years if minimal increases in Bank Rate materialise. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. The market is currently pricing in the next increase in Bank Rate for the second half of 2019.

1.3 With regard to unemployment, on the Independent Labour Organisation measure this is now at a 43 year low of 4%, but there is not much in the way of wage pressure at present. This is a global theme for the major economic power houses of the world. Indeed, with UK wages running in line with the CPI measure of inflation, real earnings are, in effect, neutral. Given the UK economy is very much services sector driven, any weakness in household spending power is likely to materialise in the form of tepid growth. This is another reason why the MPC must tread cautiously before increasing Bank Rate further. Additionally, business sentiment surveys, such as the Purchasing Managers Index collated by Markit, suggest the UK is set for growth of no more than 0.8% in the second half of 2018, whilst the housing market is going through a weak phase – with UK-wide house price growth in the region of 2% to 3%, but with areas of London and the south-east experiencing price falls.

1.4. From a political perspective, there is always the possibility of the Conservative minority government imploding over Brexit issues, but our central position is that Prime Minister May's government will muddle through despite various setbacks along the route to Brexit. If, however, we find ourselves facing a General Election in the next 12 months, there could be a potential loosening of monetary policy as a consequence, whilst medium to longer dated gilt yields could rise on the expectation of a weak £ and concerns of inflation picking up.

1.5 Looking at the US, President Trump's massive easing of fiscal policy has led to a (temporary) boost in consumption which has fuelled strong growth, upwards of 1% in Q2 2018, but also inflationary factors. With inflation moving towards 3%, the Fed has already tightened the Fed Funds interest rate to between 1.75% and 2%, and a further two increases to 2.25% - 2.5% is expected before the end of 2018 with the prospect of another increase or two next year. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US (China in particular) could see a switch to US production of some of those goods but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

1.6 In respect of the Eurozone, growth has undershot early forecasts for a strong economic performance in 2018. In particular, data from Germany has been mixed – and they too could be negatively impacted by US tariffs on a significant part of their manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

1.7 Interest Rate Summary

In summary, our forecasts assume a modest and careful set of increases in Bank Rate over the next three years, with the next increase pencilled in for May 2019, but much of any monetary policy tightening will be dependent on an orderly Brexit. We forecast Bank Rate to be at 1.5% at March 2021. We also believe that where the Bank of England has stated that the neutral rate for Bank Rate will be in the range of 2% to 3% in the medium term, the fragility of consumer confidence and the current housing market, paired with little evidence of a substantive real wages increase occurring, suggests Bank Rate would settle at the lower end of this spectrum in the current economic cycle.

1.8 Our central view also assumes only a modest upward movement in gilt yields through to 2021 as the economy performs broadly in line with the levels forecast by the Bank of England. Our PWLB Certainty Rate forecasts are set out below.

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

1.9 Naturally, uncertainties abound and chief amongst those from an international perspective are the following:

- The degree to which the various on-going trade and geopolitical spats involving the US impact investor confidence on a global scale. In recent months, we have seen verbal confrontation, with economic policy implications, involving North Korea, the Eurozone, Canada, Russia and Turkey to name but a few.

- In addition, Italy has a populist government comprising the Northern Alliance and the Five Star Movement. There is the possibility that an anti-EU/austerity policy snowballs in the coming months with repercussions for the EZ bloc as a whole.

- Oil prices have risen substantially over the course of the last 12 months, any further protracted increases in oil or other core commodity prices could have a destabilising effect on global growth.

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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.

Constant Net Asset Value (CNAV) – refers to Funds which use amortised cost accounting to value all of their assets. The aim is to maintain a Net Asset Value (NAV), or value of a share of the Fund at £1.

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 than 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.

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Manchester City Council
Report for Information

Report to: Audit Committee – 5 November 2018

Subject: Progress report on Manchester City Council's Commissioning and Contract Management

Report of: City Treasurer

Summary

This paper summarises progress against the actions set out in the contract management improvement work plan approved by the council's Senior Management Team on 27 February and the recommendations of the Audit Committee in January.

A great deal has been achieved in the last seven months, with notable progress on completion and analysis of contract registers, the development of standard products and processes, and growing awareness and tools for monitoring social value in contract delivery. However, the scale and complexity of the challenge should not be underestimated, given the number, value and variety of external contracts, the Council's ambition for delivering for Manchester residents, and the pressing need to maximise value for money. This is a long-term improvement programme, and there remains much work to be done.

Recommendations

That the Committee notes the progress made to date but also the continued work that is needed. Section 3 of the paper sets out the key next steps in the work plan.

Wards Affected: All

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Background documents (available for public inspection):

Improving Contract Management and Governance, Audit Committee, January 2018

1. Background

1.1 The function of commissioning, procurement and contract management is essential for meeting the objectives of the City Council in the most cost effective and efficient manner. The Council currently commissions and procures over £0.5bn of services from third parties, the scale of which illustrates the importance of this function.

1.2 On 27 February 2018, the council's Senior Management Team (SMT) endorsed the work plan and priorities for the commissioning and contract management improvement programme. The work plan aims to build on existing strengths as well as address weaknesses as identified in previous reviews and audit reports. The areas for improvement are set out more fully in the January report to Audit Committee earlier this year; as a recap:

- Strategic governance and oversight of contracts was limited, hampered by inconsistent and, in places, incomplete reporting of contract data and performance;
- Contract management processes and systems were inconsistent and too easily prone to failure (e.g. limited controls and guidance increased the risk of human errors; knowledge of contracts too often lay with the individual commissioner / contract manager as opposed to being captured systematically);
- Basic standards for monitoring performance, such as monitoring meetings with providers, and the regular reviewing of performance information, were not always being followed;
- Staff and managers alike wanted more development opportunities to build commercial and contract management skills;
- The contract design stage needed a greater emphasis on how the contract will be managed, both in terms of establishing well-designed key performance indicators that closely align with the outcome goals of the contract, and practically in how the supplier relationship will be managed; and
- There could be insufficient consideration of social value opportunities built into specifications, and monitoring of social value delivery was lacking at times.

1.3 In addition to endorsing the proposed improvement programme overall, the January Audit Committee made a number of specific recommendations, as follows:

- The completion of a standard contract register;
- Use of contract performance dashboards for monitoring contracting effectiveness at a directorate level;
- More robust approach to contract management in new contracts;
- Strengthened governance in relation to contract management;
- Introduction of an improved ICT system for managing contracts.

1.4 This paper summarises the progress made both on these recommendations and for the overall improvement plan over the last six months as well as the priorities for the next six months.

2. Progress

Ensuring effective strategic oversight and governance

2.1 There are now contract registers in place across the directorates which provide the foundation for an improved grip on contract performance and spend. The registers are largely complete (a significant achievement), and present data in a consistent standard format, allowing comparison and analysis. There is still work to do to refine these - for example, they are necessarily still largely spreadsheet-based and the intention is to capture richer data. One exercise currently in train is the assessment of all the council's contracts for their criticality (Gold, Silver, Bronze - determined by value, dependence, impact, reputational risk and security/ safeguarding) and for their current performance (Red, Amber, Green - determined by service quality, consistency with Our Manchester behaviours, effectiveness in managing change, delivering on budget, and delivering social value), which in turn will help Directorate Management Teams take action on the key areas for attention.

2.2 Assurance reporting to Directorate Management Teams (DMTs), the Commercial Board and the Senior Management Team has improved to support senior oversight. Building on the data in contract registers we now have draft dashboards, summarising key data such as number of contracts, contract spend, number of contracts procured under a waiver to tender, activity, performance and contract breaches. These are new but they are starting to be reviewed by Directorates, as well as the Commercial Board - Neighbourhoods is one example which has set up dedicated meetings on contract management, where the contract register, dashboard and summary commentary all form key inputs into the meeting.

2.3 New accountability arrangements have been agreed by the Commercial Board relating to:

(i) contract approvals governance - ensuring appropriate governance at each stage of the commissioning cycle; and

(ii) new procedures for strengthening contract management in pre-tender and tender stages. These are now with directorates for implementation. The Integrated Commissioning Team is developing a communications plan to spread and embed the message across the council. The team is also working with Manchester Health and Care Commissioning (MHCC) and the Manchester Local Care Organisation (LCO) on the future framework for governance of council-funded social care contracts.

2.4 Key forward priorities are:

(i) to support Directorate management teams and SMT in confirming a forward pipeline of commissions and contracts, to shape these in line with strategic objectives, and oversee the performance of externally contracted services; and

(ii) to facilitate cultural change, giving greater prominence and priority to effective contract management. In practice, this means:

- completing Commissioning Pipelines (ie procurement plans) - which do not yet exist for all services;
- ensuring those plans meet Manchester's strategic objectives - which is likely to mean integration across some contracts, redesigning some, and decommissioning some; and
- raising performance in terms of robust and effective contract management.

Processes and systems

2.5 Following a series of workshops with practitioners across the Council, standard processes now exist for commissioning and contract management. Directorates are working to implement these; key actions for the Integrated Commissioning Team are communicating and embedding these. Some Directorates also now have identified roles with specific responsibility for improving contract management across the directorate, which is helping to embed better practice. As an example, Highways now have a dedicated Social Value and Ethical Procurement lead, supporting across the commissioning cycle from initial design, to monitoring delivery of social value commitments under the contract.

2.6 In addition, the Integrated Commissioning Team also put forward to the Commercial Board specific proposals to strengthen consideration of contract management within the contract design stage. As a practical example, when commissioning officers seek relevant authority, such as a Strategic Director, for proceeding with a new commission, they have to demonstrate how they propose to manage the contract. The next step is to ensure implementation in practice, including with Legal Services to ensure that this is captured in standard City Council terms and conditions for contracts.

2.7 As mentioned in the report to the January Audit Committee, improved ICT systems and capability are required to support contract management, to ensure an effective interface between operational workflow, outcomes, financial management, and payments systems. There are two principal requirements:

(i) To record and track contract lifecycle processes, such as a contract register, recording the relevant parties to contracts, key dates for action and renewal; and
(ii) Capability to support the performance management and assurance of contracts, such as monitoring expenditure and performance against contracts.

This forms part of the ICT investment plan, and work started in April on defining requirements; design and procurement is due Q2 2019 (slipped from Q1), and implementation is due Q4 2019. In addition, work is at an early stage on a change to SAP to capture contract reference data, to enable the tracking of expenditure against contracts.

Resourcing, skills and capability

2.8 Work is underway to establish a learning and development programme for 2018/19 and 2019/20, the purpose of which is to raise the prominence of contract management as a career path, and improve staff skills and capability in this area (eg confidence in negotiation and understanding of business and commercial practices).

2.9 Since the beginning of October, Finance and Integrated Commissioning are co-delivering a dedicated session on financial and contract management on the Our Manchester Leadership and Raising the Bar programmes. These are large-scale development programmes and staff who have attended the course previously will be asked to attend this additional session. Furthermore, the Council is designing an e-learning course for contract management, which is expected to be ready during the autumn period. Further plans for a more in-depth commissioning and contract management course for dedicated commissioning and contract management roles are also being considered, subject to available funding. Meanwhile, staff from the corporate Integrated Commissioning team have supported Directorates with advice and expertise.

Supplier management and contract monitoring

2.10 Staff from the small corporate Integrated Commissioning Team have been deployed to priority contracts, including external residential and foster care for Children’s Services; education contracts; procurement of social care contracts that must be in place by April 2019; parking; Highways; and monitoring the delivery of social value. Directorate contract staff and the Integrated Commissioning Team are working together to implement the new contract management standards; and to introduce a systematic approach to addressing risk - identifying, and planning the handling of, high risk contracts, opportunities for innovation and improvement, and savings. The next step will be to further develop Directorate contract management improvement plans to ensure consistent implementation, reflecting where the Directorate is on its improvement journey, and progress towards the Council's priorities.

2.11 At an operational level, the majority of contracts now have named officers (including Senior Responsible Officer and Contract Manager). There is still further work needed to clarify and embed the new responsibilities for governance of individual contracts, including ensuring contract management and monitoring meets new corporate standards - both in the Council and in MHCC, where joint work is underway.

Social Value

2.12 Social value is a key deliverable in the wider Council agenda to improve contract monitoring and management more generally. Commissioning for, and monitoring delivery of, Ethical Procurement has been included in all the new contract management standards and tools, with Social Value one of the cornerstones of an ethical procurement approach. A Social Value Toolkit for Commissioners and Stakeholders has been developed by a working group led by Corporate Procurement, and was launched at the Council's annual Ethical Procurement event in March. The Social Value Senior Leaders Group recently recommended focusing on effective delivery and monitoring of Social Value commitments in contracts, with an emphasis on practical actions to embed good practice and change culture, including:

- Ensuring that Social Value and the monitoring of Social Value is explicitly covered at the commissioning and pre-tender stages;
- Ensuring that Social Value and the monitoring of Social Value is explicitly covered at the tender stage;
- Benchmarking Social Value KPIs, starting with the "gold" contracts;
- Monitoring the delivery of social value once contracts are live;
- Building capability and winning hearts and minds among leaders and staff.

3. Next steps

3.1 The overall focus now is on embedding new standards and ways of working within directorates, and on focusing on the upcoming pipeline of commissioning and contracting activity over the next three years, specifically:

- Strategic oversight: new accountability arrangements; forward pipeline of commissions; performance of externally contracted services;
- Assurance reporting: to DMTs, Commercial Board and SMT;
- Forward planning: of commissioning and procurement;
- Standard processes: implementation;
- ICT: delivery of the contract management system;
- Learning and development: roll-out of new programmes;
- Resourcing operational governance: directorates to ensure contract management and monitoring meets new corporate standards;
- Supplier monitoring: continue to drive improvement;
- Delivery of Social Value in contracts.

3.2 The team is also working with Manchester Health and Care Commissioning (MHCC) and the Manchester Local Care Organisation (LCO) on the future framework for governance of council-funded social care contracts. Joint work is under way on aligning existing CCG and City Council contracts; and a new Director of Market Engagement has been appointed in MHCC, reporting to the Executive Director Strategic Commissioning and Director of Adult Social Services (DASS).

3.3 **Strategic oversight**: the new and clarified accountability arrangements are being set out in the Constitution, for ratification by full Council in late November. Commercial Board will support Directorate management teams and SMT in scrutiny of the forward pipeline of commissions and assurance of DMT oversight of the performance of externally contracted services. Ongoing.

3.4 **Assurance reporting**: DMTs to embed review of Directorate commissioning plans and contract performance into business as usual - on quarterly basis. Commercial Board to assure directorate commissioning pipelines and contract performance, and provide cross-cutting overview and connections. Ongoing.

3.5 **Forward planning**: Directorates will develop forward commissioning pipelines on the basis of risk and criticality, and reflect in service and budget plans - first drafts to be complete by December 2018, to be combined in City Council and MHCC forward planning. In 2019 we would expect to see the impact of better forward planning in: fewer waivers, fewer extensions, and increased negotiation on value in contract extensions.

3.6 **Implementation of new contract management standards**: these consist of standards (eg for contract registers), tools (eg assessing contract risk and criticality), and guidance (how to guides). They are now published on the intranet. DMTs will work with their contract management leads in directorates to ensure implementation. Integrated Commissioning are supporting with a communications drive (launch by end December 2018) and by embedding the new standards within training. Legal colleagues have revised standard City Council terms and conditions for contracts and are working on protocols and processes for the formalisation of contracts. Once these are finalised they will be embedded in guidance for MCC commissioning and contract staff.

3.7 **ICT systems**: key deliverables are the contract management system (target delivery end 2019); Liquid Logic and Controcc systems (May 2019); and SAP system change (currently at scoping definition stage).

3.8 **Learning and development**: the key deliverable is to establish and deliver a contract management learning and development programme for 2018/19 and 2019/20, including new training programmes for managers (Raising the Bar; Our Manchester Leadership), starting in October. An e-learning module on contract management is in development; another on delivering Social Value in contracts is planned. Both are targeted at all commissioners and contract managers. Additional specialist training for commissioners and managers of complex contracts and commercial projects is planned, subject to available funding. Commissioning staff are entitled to apply for places with the new Greater Manchester Commissioning Academy programme, starting in January 2019 that focuses on GM commissioning into the future. The key deliverables are for Directorates to incorporate commercial management (commissioning and contracts) training requirements into their 2019/20 Workforce Plans.

3.9 **Resourcing operational governance**: There is still further work needed in directorates to clarify and embed the new responsibilities for commissioning, governance of individual contracts, including ensuring contract management and monitoring meets new corporate standards - by December 2018.

3.10 Supplier monitoring: Directorates to analyse the performance of their suppliers and contracts on a risk basis, and develop contract management improvement plans to resource to risk and criticality; follow through in 2019/20 service and budget plans. The City Council procurement process is being amended to ensure that as part of their tenders, bidders submit proposals for managing contract performance, and this is evaluated. The corporate Integrated Commissioning Team will remain focussed on priority areas. Commercial Board to review "gold" critical contracts.

3.11 **Social Value**: This has been and will continue to be a high priority area. Looking ahead, there will continuation of the drive to deliver social value through the commissioning and contract management programme, using the new commissioners' toolkit. Key deliverables:

- Strategic Directors and delegated contract approvers to scrutinise proposals to ensure Social Value is included;
- Directorate contract leads to benchmark Social Value KPIs; and
- Contract managers to track the delivery of Social Value as part of routine management. Officers are driving Ethical Procurement in all its aspects through commissioning and contract management.

4. Conclusions

4.1 The Council's commissioning and contract management has improved this year, and the foundations have been laid for the future - with contract registers in place across Directorates and improved governance and strengthened reporting at senior levels.

4.2 The priorities ahead are the continuing work with Directorates to implement the new standards and plan the forward pipeline of commissions and contracts. This better planning should deliver a significant reduction in the number of waivers to tender, eliminate spend off-contract, and help to identify opportunities for efficiencies - either through contract redesigns, or renegotiation with providers in relation to existing contracts. The Council recognises this is as much about a cultural change as much as process, which is why we are also taking steps to support different ways of working, including further training for staff.

5. Recommendations

5.1 The recommendations appear at the front of this report. Section 3 of this paper sets out the key next steps in the work plan.