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MANCHESTER
CITY COUNCIL

Audit Committee

Date: Tuesday, 28 July 2020
Time: 10.00 am
Venue: Virtual meeting - https://manchester.public-i.tv/core/portal/webcast_interactive/485320

The Local Authorities and Police and Crime Panels (Coronavirus) (Flexibility of Local Authority and Police and Crime Panel Meetings) (England and Wales) Regulations 2020

Under the provisions of these regulations the location where a meeting is held can include reference to more than one place including electronic, digital or virtual locations such as Internet locations, web addresses or conference call telephone numbers.

To attend this meeting it can be watched live as a webcast. The recording of the webcast will also be available for viewing after the meeting has ended.

Membership of the Audit Committee

Councillors - Ahmed Ali (Chair), Clay, Lanchbury, Russell, Stanton and Watson

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

Agenda

Information about the Committee

The Committee is responsible for approving the Council's statement of accounts; considering the Audit Commission's Annual Audit and Inspection Letter and monitoring the Council's response to individual issues of concern identified in it. The Committee also considers the Council's annual review of the effectiveness of its systems of internal control and assurance over the Council's corporate governance and risk management arrangements, and engages with the external auditor and external inspection agencies to ensure that there are effective relationships between external and internal audit.

The Council is concerned to ensure that its meetings are as open as possible and confidential business is kept to the strict minimum. When confidential items are involved these are considered at the end of the meeting at which point members of the public are asked to leave.

The Council welcomes the filming, recording, public broadcast and use of social media to report on the Committee's meetings by members of the public.

Agenda, reports and minutes of all Council Committees can be found on the Council's website www.manchester.gov.uk.

Smoking is not allowed in Council buildings.

Joanne Roney OBE
Chief Executive
Level 3, Town Hall Extension,
Albert Square,
Manchester, M60 2LA

Further Information

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

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This agenda was issued on **Monday, 20 July 2020** by the Governance and Scrutiny Support Unit, Manchester City Council, Level 3, Town Hall Extension (Lloyd Street Elevation), Manchester M60 2LA.

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Audit Committee

Minutes of the meeting held on 10 March 2020

Present:
Councillor Ahmed Ali - In the Chair
Councillors Clay, Lanchbury, Stanton and Watson
Independent Co-opted members: Dr S Downs

Also Present:
Karen Murray, Mazars

Apologies: Dr Barker, Independent Co-opted member
Councillor Ollerhead, Executive Member Finance and Human Resources

AC/20/06 Minutes

Decision

To approve the minutes of the meeting held on 11 February 2020 as a correct record.

AC/20/07 Register of Significant Partnerships

The Committee considered the report of the Deputy Chief Executive and City Treasurer that presented the Register of Significant Partnerships 2019. The format, and the review and assurance process associated with the register was outlined in the report. The report focused on partnerships which had been added to the Register during 2019 and those where the governance strength rating had changed, or where the rating remained ‘Medium’ or ‘Low’ strength following completion of the latest self-assessment. The full draft Register was included as an appendix to the report.

In response to questions from the Committee, the Directorate Lead, Corporate Planning and Governance stated that a review would be undertaken of how this register was produced to strengthen the reporting and value of the document. He stated that the review would allow for consideration to be given as to the frequency of the reporting, reflect upon and identify any improvements to the reporting process. He stated that consideration would also be given as to whether an additional metric of rating could be introduced to strengthen the document and that the Committee would be kept informed as this work developed.

In response to a Members question regarding plans for when the current Strategic Director Growth and Development left his post, the Deputy Chief Executive and City Treasurer stated that whilst not wishing to pre-empt any final decisions, the knowledge of all the partnerships and responsibilities was distributed across a number of officers within the Council.

In response to the reported rating of Medium for Manchester Health and

Care Commissioning (MHCC), the partnership between the Council and CCG to create a single health, social care and public health commissioning function for Manchester, the Director of Policy, Performance and Reform advised that work continued to progress in regard to this activity and commented upon the existing complex systems within the different organisations and the challenge this represented. However, he reassured the Committee that progress continued to be made. The Head of Internal Audit and Risk Management stated that a governance audit of MHCC had been undertaken approximately 12 months ago and progress continued to be made against those findings that had resulted in the Medium rating being awarded. The Directorate Lead, Corporate Planning and Governance directed Members to the section of the report that described the criteria applied to the awarding of the different ratings and described that these had been applied and that those ratings were reviewed by a moderation panel to ensure they were applied consistently and correctly.

In response to a Members comment regarding the importance of transition planning from Children Services to Adult Service, the Director of Policy, Performance and Reform advised Members that this was recognised and the respective services were actively working to improve transition pathways.

In response to a Members question regarding Northwards, the Deputy Chief Executive and City Treasurer informed the Committee that a review of ALMO (Arm's-length management organisations) governance arrangements was currently underway to ensure the existing arrangements were satisfactory, and the findings of this review would be reported at an appropriate time.

In response to a specific question regarding the Brunswick PFI, the Head of Internal Audit and Risk Management advised the Committee that he would look into this and provide an update to the Committee at an appropriate time.

Decisions

The Committee note the report.

AC/20/08 Accounting Concepts and Policies, Critical Accounting Judgements and Key Sources of Estimation Uncertainty

The Committee considered the report of the Deputy Chief Executive and City Treasurer that explained the accounting concepts and policies, critical accounting judgements and key sources of estimation uncertainty that would be used in preparing the 2019/20 annual accounts. It also contained details of the new International Financial Reporting Standard (IFRS) 16 on leasing that was to be fully introduced by Local Government on 1 April 2020.

In response to a question from a member of the Committee regarding the anticipated impact on staff capacity to implement the International Financial Reporting Standard (IFRS) 16 on leasing, the Deputy City Treasurer stated that this requirement had been factored in to the teams’ work planning.

Members noted the consequences of recent global events on world markets and the impact this could have on pension funds. The External Auditor acknowledged this comment and informed the Committee that consideration was being given as to how to respond to and navigate this emerging situation.

Decisions

The Committee;

1. Approve the accounting concepts and policies that will be used in completing the 2019/20 annual accounts

2. Note the critical accounting judgements made and key sources of estimation uncertainty.

AC/20/09 Annual Internal Audit Plan 2020/21

Decision

To defer consideration of this report to the next meeting of the Committee.

AC/20/10 Risk Management Strategy and Risk Register

Decision

To defer consideration of this report to the next meeting of the Committee.

AC/20/11 The Committee's Work Programme

The Members considered the Committee’s work programme. A Member commented that following the decision to defer the previous two items of business to the next meeting, consideration needed to be given to the number of items of business scheduled for the next meeting. The Chair noted this comment and advised the Committee that he would discuss this with relevant officers

Decisions

The Committee note the Work Programme subject to the above comments.

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Item 5

Audit Progress Report

Manchester City Council

July 2020

MAZARS

CONTENTS

1. AUDIT PROGRESS

Purpose of this report

This report provides the Audit Committee with an update on progress in delivering our responsibilities as your external auditors.

Ensuring resilience and maintaining the level and quality of client service

Since the Committee last met the impact of the Covid-19 pandemic has changed our environment in a way not seen before. Mazars has implemented clear and decisive measures to ensure the welfare of our people and clients while ensuring that we continue to deliver for those who rely on us.

On the 17 March 2020, following Government announcements the following evening, Mazars made the decision to close its offices and require all staff to work from home. The challenges this has brought are significant and still being worked through.

Beyond protecting the welfare of our clients and people, Mazars' first priority is to continue to deliver on our business commitments. As part of our existing contingency planning, we have implemented systems and procedures to ensure continuity and to minimise any disruption. In a shifting environment, we will continue to adapt our approach to best navigate the uncertain situation while keeping our people and our clients front of mind.

Our teams have full access to remote working technology with secure access to their applications, tools and data, wherever they are, and agile working processes are well-established across the firm. All partners and staff are working remotely, and our teams are making full use of virtual meetings and agile working technology to stay connected with each other and our clients, deliver on our commitments, and provide continuity and support at the time it's most needed.

Mazars' external website contains further details of its response to the emerging situation, along with daily economic briefings.

Responding to the changes – working with the Council

We are committed to supporting the Council as best we can throughout the current period, recognising first and foremost the need to be flexible as the current environment changes, but also the significant pressures on the Council's finance team. We have continued to maintain open communication throughout the audit period.

We are able to carry out the audit remotely and have put in place arrangements to allow this, such as routine regular update meetings, use of the our Huddle file sharing site for secure transfer of data and keeping query logs. The key difference is we will not, until further notice, have a physical on-site presence. We will however maintain communication via regular webex and video calls.

Update on our proposed audit programme and external audit fees

As set out in our Audit Strategy Memorandum, presented to the Audit Committee in February 2020, we communicate promptly with you when there are changes to our audit work which may impact on the proposed level of external audit fees. There are two elements that we wish to communicate with you relating to our audit of 2019/20.

1. AUDIT PROGRESS

Public Interest Entity

The statutory audit legislation relating to Public Interest Entities (PIE) came into effect for all financial years starting on or after 17 June 2016. The PIE definition includes organisations with transferable securities listed on regulated markets and governed by law. Manchester City Council has a small amount of listed debt, and as a result the Council falls under the definition of a PIE. Consequently there are additional requirements at both the planning and the reporting stages of the audit which culminate in the requirement to produce a more detailed 'long form' audit report.

Audit Regulator recommendations

We continually strive to maintain high standards of audit quality. One mechanism for doing this is to consider the outcome of independent quality reviews of our audit work and that of other audit suppliers, in particular those carried out by the Audit Quality Review team of the Financial Reporting Council. As a result of the increased expectations on external auditors following recent reviews, we are planning increases in the level of work we carry out on:

- The value of the Council's defined benefit pension scheme assets and liabilities; and
- The value of the Council's property, plant and equipment and investment property assets, including those relating to its consolidated interests in Manchester Airport Group and Manchester Convention Centre.

We have discussed the driving factors with Council officers through our liaison discussions, and we will revisit our audit fee for 2019/20 to reflect the increased level of risk-based work that was not considered by PSAA when the scale fee was set.

The Committee should note that any agreed additional fee is subject to detailed scrutiny by the PSAA as part of the approval process.

Audit progress

With regards to our external audit of the Council, since the last Committee meeting we have:

- Maintained a regular dialogue with the City Treasurer, the Chief Accountant and the finance team. We have carried out fortnightly video calls with the finance team since March 2020 to ensure that we remain up to speed with the Council's response to the challenges and its plans regarding financial reporting.
- Revised our audit resource plans to ensure that we deliver the external audit of the financial statements in line with the Council's revised plans, as set out below. The Council intends to provide draft accounts before the end of July although this is dependent on obtaining the information from the Council's external valuer to produce the Council's group financial statements. Our revised resource plans will ensure that we complete our audit of the financial statements before the revised statutory deadline of the end of November.
- The closedown process has been understandably slower than would ordinarily be the case, with the challenges of the Council's finance team all working remotely, and having additional workload in addition to closing down the accounts. Our experience from our other audits that have been carried out since March indicate that the audit process is similarly challenging and we will keep the Council appraised of our progress once the audit has commenced.
- Liaised with the Council on specific financial reporting challenges in the current time, particularly reflecting information and views from our national networks with MHCLG, NAO, CIPFA, and other audit suppliers. For example:

1. AUDIT PROGRESS

- The significant impact of the pandemic on the financial markets means that there are likely to be significant impacts on the valuation of financial pension fund assets. We suggested that the Council in these circumstances should consider obtaining a second actuarial report from the GM Pension Fund actuary, in order that the report includes the actual return on assets for both the Council and its group subsidiary components. The Council received its updated actuarial report in June 2020.
- There is increased uncertainty around the valuation of the Council’s Property, Plant & Equipment, particularly where that valuation is based on market conditions. The Royal Institute of Chartered Surveyors (RICS) have provided guidance to their members. Consequently we expect that valuers will be actively considering the need for their valuation reports to include a reference to a material uncertainty in their valuations, reflecting the uncertainty in the market conditions that existed at 31 March 2020. Although the Council’s valuer has reported that they do not considered there to be a material impact on the valuations for 2019/20, the Council is actively discussing the specific circumstances relating to its valuations with its external valuer.
- There is increased potential for the Council’s other financial assets, for example its investments in companies, or its outstanding debtors, to require impairment, reflecting an increased likelihood of expected losses in the current economic climate.

There are no additional matters to report to the Audit Committee relating to our 2019/20 external audit.

2. NATIONAL PUBLICATIONS

	Publication/update	Key points	Page
Mazars			
1	**Mazars' response to the Brydon Review**	Mazars' response to the latest review into the auditing profession which was published in December 2019.	8
2	**Annual Transparency Report**	Sets out the steps we take to enhance the quality of our audit work and ensure that quality is consistent across the firm.	8
Public Sector Audit Appointments			
3	**Publication of 2020/21 scale of audit fees**	PSAA has written to all Councils setting out the next year's external audit fees	9
National Audit Office			
4	**New Code of Audit Practice 2020/21**	Publication of the Code of Practice that prescribes the focus of the external audit and auditor reporting for five years from 2020/21	10
5	**Local authority investment in commercial property**	Report on the developments of LA investments in commercial property	10
6	**Managing PFI assets and services as contracts end**	Information on managing PFI contracts as they come to an end	11
Chartered Institute of Public Finance and Accountancy (CIPFA)			
7	**Local Government Financial Resilience index**	Online data tool which measures local authorities against a range of indicators to assess their level of resilience.	12
8	**Financial Management Code**	Guidance for good and sustainable financial management in local authorities.	12
9	**Prudential Property Investment**	Guidance on prudent investments in commercial properties.	13
10	**IFRS9 Financial Instruments: A guide for Local Authority practitioners**	Updated guidance to assist Councils to comply with the requirements of IFRS9	13
11	**IFRS 16 Leases: An Early Guide for Local Authority Practitioners**	Guidance to assist the preparations for the 2020/21 application of IFRS16	14

2. NATIONAL PUBLICATIONS

	Publication/update	Key points	Page
Ministry of Housing, Communities & Local Government (MHCLG)			
12	**Coronavirus support package for Councils**	Press release announcing the latest government support	15
Other			
13	**Statement on Covid-19, Financial Reporting Council and other Regulators**	Statement on the impact of the Covid-19 pandemic on accounting, reporting and auditing	16

2. NATIONAL PUBLICATIONS – MAZARS

1. Mazars' response to the Brydon Review, *Mazars,* December 2019

The Brydon Review is one of four key reviews into the scope and quality of audit, namely:

- Competition and Market's Authority (CMA): resilience and competition in the audit market;
- Kingman's Review (review of the Financial Reporting Council and regulatory oversight);
- The Brydon Review (tone and aspirations for the future of the industry); and
- The Redmond Review (quality of local authority financial reporting and external audit).

The Brydon Review contains various recommendations and essentially recommends a major overhaul of audit which would see the creation of a separate 'corporate auditing profession', greater focus on fraud detection during audits, and the replacement of the 'true and fair' concept, with a greater focus on going concern.

Mazars' response to the latest Brydon Review report issued in December 2019 is detailed per the link below.

https://www.mazars.co.uk/Home/News-Events/Latest-news/Mazars-response-to-the-Brydon-report

Link to the Brydon Review

Published in December 2019, focusing on the quality and effectiveness of audit.

https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review

Link to the Kingman's Review

Published in December 2018, this review recommended the replacement of the Financial Reporting Council with a new independent statutory regulator, accountable to Parliament. The new regulator will be called the Audit, Reporting and Governance Authority (ARGA).

https://www.gov.uk/government/news/independent-review-of-the-financial-reporting-council-frc-launches-report

Link to the Redmond Review

At the time of writing this report, the outcome from the Redmond Review has not been published.

https://www.gov.uk/government/consultations/review-of-local-authority-financial-reporting-and-external-audit-call-for-views

2. Annual Transparency Report, Mazars*,* December 2019

Mazars produces an annual transparency report, setting out the steps we take to enhance the quality of our audit work and ensure that quality is consistent across the firm. The report includes:

- Public Interest Committee Report;
- UK Governance Council Report;
- Inspiring Stakeholder Confidence in Audit Quality (including quality monitoring and audit quality indicators);
- Our risks; and
- Structure, Leadership and Governance.

https://www.mazars.co.uk/Home/About-us/Corporate-publications/Transparency-reports/Mazars-UK-Transparency-Report-2018-2019

2. NATIONAL PUBLICATIONS – PSAA

3. PSAA 2020/21 scale of audit fees, March 2020

PSAA has published the fee scale for the audit of the 2020/21 accounts of opted-in principal local government and police bodies, and wrote to those bodies to notify them of the fee.

The 2020/21 fee scale document sets out the scale of fees for the audit work to be undertaken by appointed auditors in respect of the 2020/21 financial statements at relevant principal authorities that have opted into PSAA's national auditor appointment arrangements.

PSAA describes in their letter that local audit and audit more widely is subject to a great deal of turbulence with significant pressures on fees. In their letter they conclude that

"we do not expect the final audit fee to remain at that level for most if not all bodies because of a variety of change factors, the impact of which cannot be accurately or reliably estimated at this stage. The impact of these changes is likely to vary between bodies depending on local circumstances, and information to determine that impact with any certainty is not yet available. Our view is that it would also be inappropriate to apply a standard increase to all authorities given the differing impact of these changes between bodies. As the impact of these changes is understood, fee variations will need to be identified and agreed reflecting the impact on each audit."

The published scale fee for the Council's 2020/21 audit is unchanged from 2019/20 at £159,519.

https://www.psaa.co.uk/audit-fees/2020-21-audit-fee-scale/

2. NATIONAL PUBLICATIONS – NATIONAL AUDIT OFFICE

4. New Code of Audit Practice 2020/21, February 2020

The NAO have published their final draft of the Code following the consultation process. The Code has now been laid before Parliament and, subject to Parliamentary approval, will come into force on 1 April 2020. The new Code will apply from audits of local bodies' 2020/21 financial statements onwards.

Accompanying the Code is a document that sets out the issues the NAO considered as a result of the feedback to Stage 2 of the consultation on the exposure draft of the Code, and highlights the key changes made to the text of the final draft of the Code.

https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf

https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice-consultation_response.pdf

5. Local authority investment in commercial property, February 2020

In response to substantial falls in funding since 2010/11, local authorities have made reductions in revenue spending on services. Increasingly, authorities have also sought to offset funding reductions by generating new income through a range of strategies. A key component within these responses has been a rapid expansion in the acquisition of commercial property, often funded by borrowing.

The NAO estimates that authorities spent £6.6 billion on purchasing commercial property from 2016/17 to 2018/19 – 14.4 times more than in the preceding three years. This includes an estimated £3.1 billion on acquiring offices; £2.3 billion on retail property, including £759 million on shopping centres or units within them and £957 million on industrial property. The majority of the £6.6 billion was spent by only 49 local authorities, with those authorities accounting for 80% of the spend. Many authorities have borrowed to finance these purchases. The NAO estimates that between 38% and 91% of spending on these purchases across the sector was financed by borrowing in this period.

The report concludes that although there is evidence of authorities mitigating these risks, such as by recruiting specialist staff, undertaking due diligence on their purchases, drawing on external expertise and establishing contingency funds, there was room for improvement in the governance and risk mitigation arrangements of some authorities.

The Ministry of Housing, Communities and Local Government (MHCLG) is responsible for the framework of statutory codes and guidance that set the parameters for local authority borrowing and capital spending. MHCLG has made changes to aspects of the framework in response to the recent increased investment in commercial property. Recent activity has raised questions about the extent to which MHCLG can rely on the present framework to support authorities to make decisions which demonstrate good value for money.

The NAO recommends that MHCLG improves the relevance and quality of data and analysis it has on authorities' acquisition of commercial property to understand more fully any risks and to provide greater assurance that authorities are complying with the framework. It also recommends that the Ministry should review whether the current framework is still achieving its intended aims.

https://www.nao.org.uk/report/local-authority-investment-in-commercial-property/

2. NATIONAL PUBLICATIONS – NATIONAL AUDIT OFFICE

6. Managing PFI assets and services as contracts end, June 2020

The NAO have published a report providing information on managing PFI contracts as they come to an end and considering whether government is making appropriate preparations to manage the expiry of PFI contracts. There are currently over 700 operational PFI contracts in place in the UK with a capital value of £57 billion. This study focusses on the 571 English PFI contracts, excluding those for which devolved governments are responsible.

The purpose of the report is to draw out the challenges and best practice that can most benefit those managing PFI contracts coming to an end. NAO identify illustrative examples from specific PFI contracts, and provide helpful prompts to draw the reader's attention to some of the potential risk's authorities may face, enabling preventative steps to be considered.

In the report, NAO examines:

- the background to PFI, the contracts which are due to expire, and the roles and responsibilities of key stakeholders;
- the skills and capabilities of authorities for the expiry process and aspects of day-to-day management of the contracts relevant for the preparation process; and
- the preparation for and delivery of contract expiry.

https://www.nao.org.uk/report/managing-pfi-assets-and-services-as-contracts-end/

2. NATIONAL PUBLICATIONS – CIPFA

7. Local Government Financial Resilience index, CIPFA, December 2019

The resilience index is an online data tool which measures local authorities against a range of indicators to assess their level of resilience against financial shocks and to support financial decision making. Upper tier authorities are judged against nine indicators including social care.

The indicators measured include:

- levels of reserves;
- change in reserves;
- reserves sustainability;
- interest payable/net revenue expenditure;
- gross external debt;
- social care ratio;
- fees and charges to service expenditure ratio;
- council tax requirement/net expenditure ratio; and
- growth above baseline.

The tool allows for year on year comparisons of each authority's performance, as well as comparisons with similar and neighbouring authorities. Trend analysis is also available for some of the indicators outlined above.

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-launches-local-government-financial-resilience-index

8. Financial Management Code, CIPFA, October 2019

Strong financial management is an essential part of ensuring public sector finances are sustainable. The Financial Management Code (FM Code) provides guidance for good and sustainable financial management in local authorities and aims to provide assurance that they are managing resources effectively.

It requires authorities to demonstrate that the processes they have in place satisfy the principles of good financial management. The FM Code identifies risks to financial sustainability and introduces a framework of assurance. This framework is built on existing successful practices and sets explicit standards of financial management. Complying with the standards set out in the FM Code is the collective responsibility of elected members, the chief finance officer and their professional colleagues in the leadership team. Complying with the FM Code with help strengthen the framework that surrounds financial decision making.

The FM Code built on elements of other CIPFA codes during its development and its structure and applicability will be familiar to users of publications such as The Prudential Code for Capital Finance, Treasury Management in the Public Sector Code of Practice and Code of Practice on Local Authority Accounting in the United Kingdom.

The Code applies to all local authorities, including police, fire and other authorities.

By following the essential aspects of the FM Code, local authorities are providing evidence to show they are meeting important legislative requirements in their jurisdictions.

The first full year of compliance will be 2021/22. This reflects the recognition that organisations will need time to reflect on the contents of the Code and can use 2020/21 to demonstrate how they are working towards compliance.

https://www.cipfa.org/policy-and-guidance/publications/f/financial-management-code

2. NATIONAL PUBLICATIONS – CIPFA

9. Prudential Property Investment, CIPFA, November 2019

Increasingly there has been a move towards investments in commercial properties, funded by borrowing, with the key driver of this activity appearing to be the generation of revenue. This publication provides guidance on making the assessments needed to ensure that such acquisitions are prudent and on the risks local authorities must manage when acquiring property.

Statutory investment guidance from the Ministry of Housing, Communities and Local Government (MHCLG) last year set out clearly that local authorities need to consider the long-term sustainability risk implicit in becoming too dependent on commercial income, or in taking out too much debt relative to net service expenditure.

The increased scale of investment in property was recognised by revisions to CIPFA's Prudential Code for Capital Finance and the Treasury Management Code in 2017, but the growing amounts being borrowed for such a purpose are putting a strain on the creditability of the Prudential Framework and reinforce the need to ensure that such acquisitions are affordable, prudent and sustainable.

In addition to the core issue of borrowing in advance of need, which the Prudential Code has very clear provisions on, this publication provides guidance on the risk perspective to the practical assessment of prudence and affordability. Those risks could be very difficult to manage. Even when these issues are managed and there is reliance on investment income, a potential failure or a downturn of the property market may have a direct impact upon local services.

This publication considers such issues and the actions local authorities would need to take to mitigate against such risks.

https://www.cipfa.org/policy-and-guidance/publications/p/prudential-property-investment

10. IFRS 9 Financial Instruments: A Guide for Local Authority Practitioners, CIPFA, December 2019

The Code of Practice on Local Authority Accounting in the UK adopted IFRS 9 Financial Instruments in its 2018/19 edition, with an application date of 1 April 2018.

In order to allow practitioners to prepare in good time, CIPFA issued guidance in 2017 in advance of the 2018/19 Code being published, based on a companion publication to the 2017/18 Code: Forthcoming Provisions for IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers in the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

This publication updates the 2017 guidance to reflect:

- provisions in the 2018/19 Code that were not included in the Forthcoming Provisions publication
- changes to the 2019/20 Code resulting from amendments to IFRS 9
- experience of implementing IFRS 9 in the 2018/19 annual accounts.

This guidance provides comprehensive coverage of the requirements of the Code, including recognition, measurement, treatment of gains and losses, derecognition and presentation and disclosure in the financial statements. It also covers statutory reversals and the continuing impact of transitional provisions.

https://www.cipfa.org/policy-and-guidance/publications/i/ifrs-9-financial-instruments-a-guide-for-local-authority-practitioners

2. NATIONAL PUBLICATIONS – CIPFA

11. IFRS 16 Leases: An Early Guide for Local Authority Practitioners, CIPFA, December 2019

Although changes will not have an effect until the 2021/22 financial statements, CIPFA/LASAAC consulted in the summer of 2018 on amendments to the Code of Practice on Local Authority Accounting for IFRS 16 Leases. The Standard is expected to have a potentially significant practical and financial effect for local authorities, and it was considered that early notice of the technical requirements was advisable.

It will be of wide interest because of the prevalence of leasing in local government and the risk that the changes could have a budgetary impact if not managed effectively.

This guidance provides comprehensive coverage of the proposed requirements for lessees, including the accounting definition of a lease, recognition of assets and liabilities, measurement, derecognition and presentation, and disclosure in the financial statements. Although there have not been significant changes to the requirements for lessors, the guidance includes extensive commentary of this area.

The guidance covers in particular:

- identifying arrangements that meet the accounting definition of a lease
- determining the term of a lease where there are options to extend or terminate
- for lessees:
  - recognising right-of–use assets and lease liabilities, and their initial and subsequent measurement
  - reassessment of lease liabilities and treatment of lease modifications
- for lessors, distinguishing between finance and operating leases and accounting accordingly
- dealing with sale and leaseback transactions
- presenting lease transactions and balances in the financial statements
- disclosure of information about leases in the notes to the accounts
- harmonising with statutory accounting requirements
- the mechanics of making the transition in the 2021/22 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

https://www.cipfa.org/policy-and-guidance/publications/i/ifrs-16-leases-an-early-guide-for-local-authority-practitioners

2. NATIONAL PUBLICATIONS – MHCLG

12. Coronavirus support package for Councils, July 2020

On 2nd July 2020 MHCLG announced the latest support package for Councils to respond to the challenges of the Covid-19 pandemic. The press release announced a further, unringfenced £500 million to respond to spending pressures they are facing. In addition the announcement highlighted a new scheme to reimburse lost income, whereby where Councils' losses are more than 5% of their planned income from sales, fees and charges, the government will provide cover them for 75% of the lost income. Furthermore the Local Government Secretary also announced a proposal for a phased repayment of council tax and business rates deficits over 3 years, rather than requiring complete repayment of deficits next year.

https://www.gov.uk/government/news/comprehensive-new-funding-package-for-councils-to-help-address-coronavirus-pressures-and-cover-lost-income-during-the-pandemic

2. NATIONAL PUBLICATIONS – OTHER

13. Statement on Covid-19, Financial Reporting Council and other Regulators, March 2020

A joint statement was issued by the Financial Reporting Council, the Financial Conduct Authority and Prudential Regulation Authority in response to the current situation.

The statement sets out that:

"*Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity. Equity and debt capital markets play a vital role providing finance to these businesses and will aid the recovery. Governments and regulators around the world remain focused on keeping capital markets open and orderly.*

Capital markets rely on timely, accurate information. Investors and other stakeholders rely on financial reporting – backed by high-quality auditing. However, companies and their auditors currently face unprecedented challenges in preparing and auditing financial information"

The statement highlights:

- The likelihood of an increase in the number of modified audit opinions (where there are difficulties in obtaining evidence or other issues);
- Increased going concern assumption considerations and uncertainties; and
- Guidance for companies and auditors.

https://www.fca.org.uk/news/statements/joint-statement-fca-frc-pra

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Manchester City Council
Report for Information

Report To: Audit Committee – 28 July 2020

Subject: Treasury Management Annual Report 2019-20

Report of: Deputy Chief Executive and City Treasurer

Purpose

To report on the Treasury Management activities of the Council 2019-20.

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 2019-20 (Executive - 13 February 2019, Resource and Governance Scrutiny Committee - 25 February 2019, Council - 8 March 2019).

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.

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 12th November 2019, 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 2020
Section 3: Review of Economic Conditions
Section 4: External Borrowing in 2019-20
Section 5: PWLB Policy Change
Section 6: Compliance with Prudential Indicators and Treasury Limits
Section 7: Investment Strategy for 2019-20
Section 8: Temporary Borrowing and Investment for 2019-20
Section 9: COVID-19 Pandemic
Section 10: Conclusion

Appendix A: Public Works Loans Board (PWLB) Interest Rates
Appendix B: Treasury Management Prudential Indicators
Appendix C: Review of Economic Conditions, provided by advisors
Appendix D: Glossary of Terms

2 The Council's Portfolio Position as at 31st March 2020

2.1 As outlined in the approved Treasury Management Strategy for 2019-20 it was anticipated that there would be a need to undertake some permanent borrowing in 2019-20 to fund the capital programme and to replace some of the internally borrowed funds. However, as noted in the interim report, cash balances during the year remained relatively high and no borrowing was required for most of the year. Temporary borrowing was taken at the end of the financial year to unwind internal borrowing and support the cash flow in response to the effects of the COVID-19 pandemic, and to fund the novation of the Homes and Communities Agency (HCA) City Deal Receipts to the Greater Manchester Combined Authority (GMCA).

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

Loan Type	31st March 2019				31st March 2020			
	GF	HRA	Principal	Average Rate	GF	HRA	Principal	Average Rate
	£m	£m	£m	%	£m	£m	£m	%
PWLB	150.0	0.0	150.0	2.45	150.0	0.0	150.0	2.45
Temporary Borrowing	4.9	0.0	4.9	0.75	30.8	0.0	30.8	0.98
Market Loans	338.0	62.2	400.2	4.50	336.8	61.9	398.7	4.48
Stock	0.9	0.0	0.9	4.00	0.9	0.0	0.9	4.00
Government Lending	52.0	0.0	52.0	0.00	26.8	0.0	26.8	0.00
Gross Total	**545.8**	**62.2**	**608.0**	**3.58**	**545.3**	**61.9**	**607.2**	**3.60**
Housing Investment Fund (HIF) Temporary Borrowing	118.8	0.0	118.8	0.00	0.0	0.0	0.0	0.00
Temporary Deposits	(80.6)	0.0	(80.6)	0.64	(128.4)	0.0	(128.4)	0.33
Internal Balances (GF/HRA)	35.4	(35.4)	0.00	0.00	42.3	(42.3)	0.00	0.00
Net Total	**619.4**	**26.8**	**646.2**	**-**	**459.2**	**19.6**	**478.8**	**-**

2.3 The temporary borrowing and deposit figures fluctuate daily to meet the cash flow requirements of the Council. The figures for these categories in the table above represent, therefore, a snapshot at a particular point in time.

2.4 Total debt has decreased slightly by £0.8m during the year. This has been mainly due to the maturity of £1.5m Commerzbank AG loan on the 31st of January 2020 as well as the transfer to the GMCA on the 30th March 2020 of £29.2m HCA government lending which included £1.6m received in year. These transactions were partially offset by new temporary borrowing of £25.9m, and a net increase of £2.4m SALIX loans throughout the year.

2.5 Since its inception the Housing Investment Fund (HIF) for Greater Manchester has been managed by the City Council at a transactional level on the basis that the GMCA did not have the relevant borrowing powers to be able to hold the Government funding for the activity. Once the relevant borrowing powers were granted in 2018-19, the debt was novated to the GMCA and the process of novating the associated investments began – this meant that the GMCA provided temporary borrowing at a nil interest rate to the value of the investments outstanding. By 31st of March 2020, all investments have novated across to GMCA, as shown in the table above.

3 Review of Economic Conditions: April 2019-20

3.1 The Bank of England maintained the lending rate at 0.75% during most of the financial year. On 11th March 2020 the rate was changed to 0.25% which was subsequently followed by another drop to 0.10% on the 19th of March 2020 in efforts to stimulate the economy during COVID-19.

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

4 External borrowing in 2019-20

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

PWLB Borrowing Rates 2019-20 for 1 to 50 years					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.37%	1.20%	1.33%	1.93%	1.77%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.67%	2.65%	2.96%	3.45%	3.25%
Date	05/12/2019	13/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	2.03%	1.97%	2.20%	2.76%	2.60%

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 In October 2019, there was a 100 basis point rise in PWLB lending rate which had significant implications on the borrowing costs for all future borrowing. Further details on the reasons for the change are provided in section 5.

4.4 Further temporary borrowing of £25m was taken for 364 days on the 26th of March 2020 to support the cash flow, due to pressures created by the COVID-19 pandemic and the novation of HCA City Deal Receipts to the GMCA.

Homes and Communities Agency (HCA)

4.5 As noted in previous reports, 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 Council held the funds, though they were administered by the GMCA.

4.6 In the year the Council received a further £1.6m of HCA funding. The Council held this arrangement on behalf of GM throughout the year and the funds were used for housing or commercial projects within GM. The funds totalling £29.2m have now been transferred across to GMCA on the 30th of March 2020 following their new borrowing powers being granted.

Housing Investment Funding (HIF)

4.7 As noted in the interim report, on 13th March 2019 the total HIF debt of £197.7m was transferred from MCC to GMCA. GMCA in return put MCC in funds for the value of the outstanding loans with developers. All the individual investments have novated across to the GMCA by the 31st of March 2020.

Salix Borrowing

4.8 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 initial advance was received in respect of specific LED lighting Council projects and will be repaid by 1st April 2023.

4.9 In the year the Council received £4.1m of new funding and £1.7m has been repaid, bring the total value of Salix to £18.4m on 31st of March 2020.

5 Public Works Loan Board (PWLB) policy change

5.1 On the 9th of October the PWLB changed its policy to increase the margin on Gilts to Gilts plus 200 basis points, and therefore the margin on the certainty rate to Gilts plus 180 basis points. This means that interest costs on future debt have increased substantially. Interest rates on PWLB debt the Council already hold have not changed.

5.2 Treasury have taken this step as small minority of local authorities have started using the low-cost loans from PWLB to buy investment property primarily for rental income increasing their risk exposure.

5.3 By increasing rates by 100 basis points the interest costs now faced by the Council are similar to those towards the end of the 2018 calendar year, which were included within the assumptions for the capital financing budget set in February of 2019.

5.4 Therefore, whilst the existing capital programme and forecast borrowing remains affordable, the true impact of the policy change is on the capacity for further borrowing in the future.

5.5 The government has launched a consultation to work with local authorities to develop a targeted intervention to stop ‘debt-for-yield’ activity while protecting the crucial work the local authorities perform on service delivery, housing, and regeneration. When announcing the consultation government suggested that the intention is that if PWLB borrowing for ‘debt-for-yield’ activity can be curtailed they would look to reduce the margin on PWLB interest rates above gilts, which currently stands at 2.00%. The consultation was intended to finish in early June, but due to COVID-19 it has been extended until the end of July.

6 Compliance with Prudential Indicators and Treasury Limits

6.1 During the financial year, the Council operated within the prudential indicators set out in the Treasury Management Strategy Statement, and performance against these is shown in Appendix B.

6.2 Further to this, the Council sets an operational limit on the cleared balance that is left within the Council’s current accounts. This is aimed at minimising the cash held in accounts which will attract no interest and thereby maximise the investment return for the authority. The limit is set at £400k and has been met during the year with the exception of seventeen breaches described below.

6.3 Where the limit is breached it means that the Council either incurred interest costs due to being in overdraft, or lost potential investment income due to excess cash not being invested. It is important to note that any such breach will be rectified the following working day, and therefore the financial impact is minimised.

6.4 The breaches of the Council's daily £400k limit on the Barclays Current Account between the 1st of April 2019 and 31st of March 2020 can be grouped under the following categories:

i. On fourteen occasions Treasury Management staff had not been advised of expected receipts, which resulted in the Current Account being outside of 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.

ii. At one occasion Treasury Management breached the £400k limit due to a payment being rejected because of inactive account details. The Shared Service Centre has been informed and the vendor has been blocked. Additional security checks with the help of Barclays have been implemented such as the Confirmation of Payee to avoid future payments going to old bank accounts.

iii. At one occasion the PWLB's direct debit failed resulting with cash not being drawn on the day and therefore breaching the £400k limit. The PWLB was informed of the error, and has since fixed the issue on their end.

iv. At one occasion, Barclays experienced a technical difficulty which prevented the Treasury Management team from being able to see closing balances. To attempt to keep the account in surplus, the £400k limit was breached which meant that overdraft charges were avoided.

6.5 Each breach was notified to the Deputy Chief Executive and City Treasurer and action taken on the following working day to bring balances back within approved limits.

6.6 All of the above breaches incurred no additional overdraft charges, however there has been some loss in potential investment income due to excess cash not being invested until the following working day.

7 Investment Strategy for 2019-20

7.1 The Treasury Management Strategy Statement (TMSS) for 2019-20 was approved by Executive on 13th February 2019. 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 The TMSS for 2019-20 contained a number of measures to broaden the Council's treasury management investment base, including use of money market funds (MMFs).

7.3 There are currently a total of five MMFs with CCLA being the latest one added on 13th August 2019. On 5th November 2019, Treasury Management Officers sought after approval from the Deputy Chief Executive and City Treasurer to increase the cash holding capacity of each fund from £12.0m to £15.0m. This was due to the current economic environment where it was becoming increasing difficult to place funds within the low rate inter local authority market. Changes to the TMSS 2020-21 have since been adjusted to reflect the higher capacity with MMFs.

7.4 During the year, additional changes were made to the Blackrock MMF allowing for a higher yield by 7.5 basis points as a result of securing lower fund management fees while maintaining equivalent levels of security and liquidity.

7.5 The current strategy means that a significant proportion of the Council's investments are with the chosen five Money Market Funds, the Debt Management Office (DMO), and other Local Authorities. This highlights the relatively low rate of credit risk that the Council takes when investing.

7.6 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.

7.7 During the financial year the Council's temporary cash balances have been managed by the Deputy Chief Executive and 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.

8 Temporary Borrowing and Investment Outturn 2019-20

8.1 Investment rates available in the market continue to be at an historical low point. The average level of funds available for investment purposes in 2019-20 was just over £94m. 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.

8.2 The average level of temporary borrowing during the financial year was £4.7m.

8.3 Detailed below is the temporary investment and borrowing undertaken by the Council. As illustrated, the Council over performed the benchmark by 19 basis points on investments due to the effective search for better inter Local Authority market rates and the use of Money Market Funds which on average had a higher return.

8.4 The temporary borrowing portfolio consisted of loans with various investment tenors ranging from call terms to fixed 2 year maturities. The average cost was therefore higher by 5 basis points when compared to the 12 month benchmark rate demonstrating value for money as the rate curve extends.

	Average temporary Investment/borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£94.1m	0.72%	0.53%
Temporary Borrowing	£4.7m	0.97%	0.92%

**Average 7-day LIBID / 12-month LIBOR rate*

8.5 None of the institutions in which investments were made, such as banks, local authorities and MMFs, showed any difficulty in repaying investments and interest during the year. The list of institutions in which the Council invests is kept under continuous review.

9 COVID-19 Pandemic

9.1 The COVID-19 pandemic has helped to create a challenging market environment in which the Council must conduct its treasury management activities. Prior to the lockdown beginning on the 23rd of March 2020, the pressure on the forecast cash flow due to the impact of COVID-19 on, for example, business rates and council tax income was becoming apparent.

9.2 In such turbulent market conditions, liquidity is extremely important and ensuring cash was available to support both COVID-19 related activity and the underlying budgeted activity was paramount.

9.3 Therefore, to provide assurance over the cash flow stability, short term borrowing of £175m was taken in early 2020-21. The borrowing consisted of cash on notice as well as 364 day fixed maturity to allow for the repayment of borrowing if the cash flow position was to improve throughout the year, helping to mitigate the risk of additional cash flow support from the Government being not made available. The loans were sourced from other local authorities, and the rates reflected the historically low rate environment in the current market.

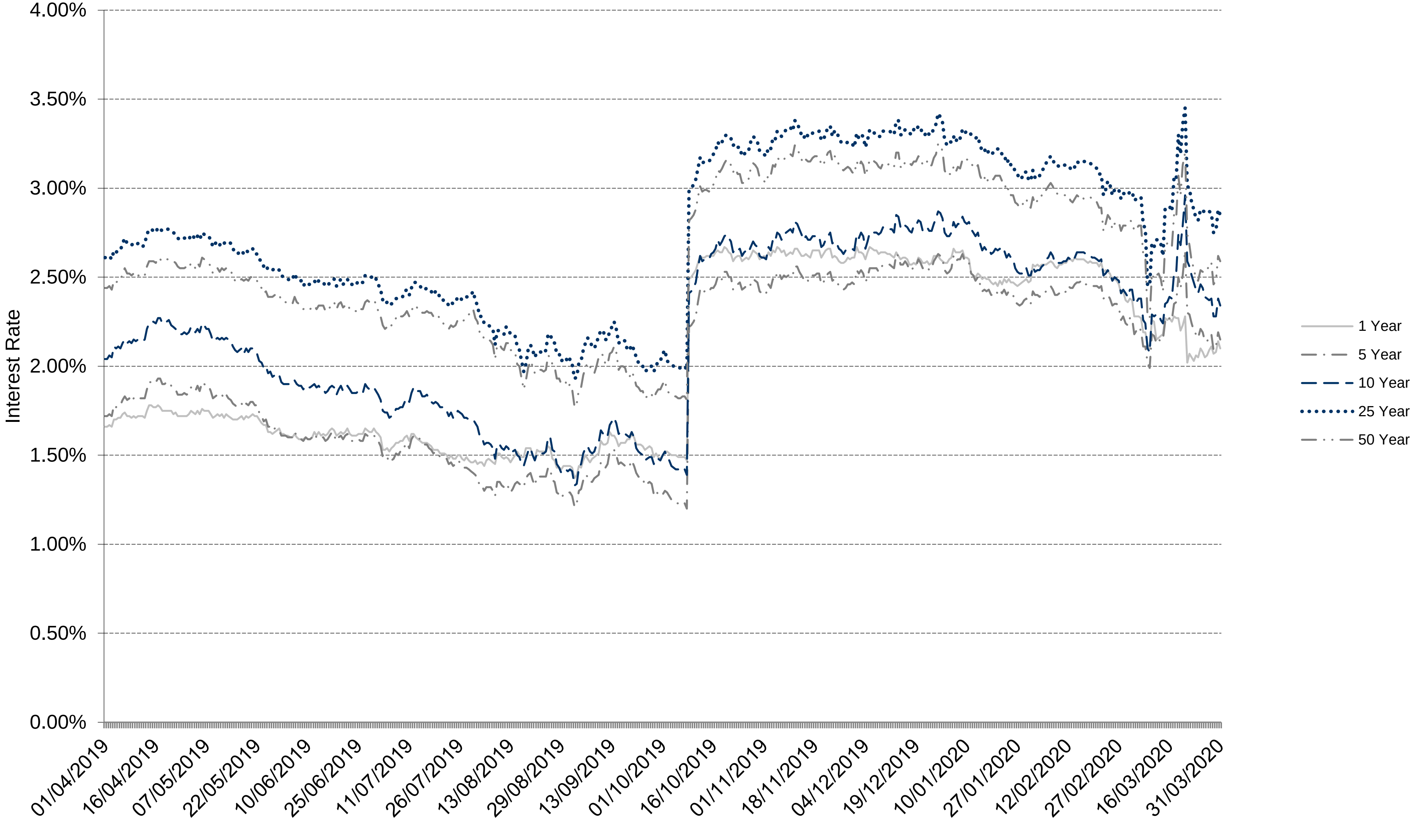
10 Conclusion

10.1 The current borrowing position continues to reflect 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. Cash balances have been relatively high during the year however towards the end of 2019-20 temporary borrowing was required to provide additional liquidity.

10.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.72%, which is higher than the benchmark average 7-day LIBID rate of 0.53% and also higher than the rate offered by the DMO, which is the default option if there are no other investment opportunities based on the credit criteria set.

10.3 Based on the current cash flow forecast, it is expected that the Council will need to borrow further funds in 2020-21. All available borrowing options will be considered, as per the Treasury Management Strategy Statement for 2020-21.

Appendix A – PWLB Interest



Appendix B

Treasury Management Prudential Indicators: 2019-20

	Original (*from 2019-20 TMSS*) £m	Minimum In Year to 31st Mar 2020 £m	Maximum In Year to 31st Mar 2020 £m
Operational Boundary for External Debt:			
Borrowing	940.9	713.6	790.7
Other Long Term Liabilities	216.0	161.5	161.5
Authorised Limit for External Debt:			
Borrowing	1,351.4	713.6	790.7
Other Long Term Liabilities	216.0	161.5	161.5
		Actual as at 31st Mar 2020	
The Council has adopted CIPFA's Code of Practice for Treasury Management in the Public Services	Yes	Yes	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit 2019-20 Original**	**Upper Limit 2019-20 Original**	**Actual as at 31st Mar 2020**
under 12 months	0%	80%	21%
12 months and within 24 months	0%	70%	15%
24 months and within 5 years	0%	50%	18%
5 years and within 10 years	0%	50%	2%
10 years and above	40%	80%	44%

Appendix C

REVIEW OF ECONOMIC CONDITIONS FOR 2019-20 AND FUTURE OUTLOOK

This section has been prepared by the Council's Treasury Advisors, Link Asset Services, for the 31st of March Closedown and includes their forecast for future interest rates after the PWLB policy change referenced in the report.

1 ECONOMIC PERFORMANCE MARCH 31st 2020

1.1 UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Theresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020. However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

1.2 Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

1.3 After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020-21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

1.4 Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

1.5 Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

1.6 USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

1.7 EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

1.8 CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

1.9 WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

Link Asset Services Interest Rate View								
	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 Month LIBID	0.45	0.40	0.35	0.30	0.30	0.30	0.30	0.30
6 Month LIBID	0.60	0.55	0.50	0.45	0.40	0.40	0.40	0.40
12 Month LIBID	0.75	0.70	0.65	0.60	0.55	0.55	0.55	0.55
5yr PWLB Rate	1.90	1.90	1.90	2.00	2.00	2.00	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50

APPENDIX D

Glossary of Terms

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

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

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.

TLTRO – Targeted Longer Term Refinancing Operations are one of the European Central Bank's monetary policy tools used to provide long term loans to banks and offer them an incentive to increase their lending to businesses and consumers.

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.