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.

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		30-Sep-18	
	Principal	Average Rate	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.