**Manchester City Council**
**Report for Information**

**Report to:** Audit Committee – 11 June 2019

**Subject:** Treasury Management Annual Report 2018/19

**Report of:** Deputy Chief Executive and City Treasurer

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## Summary

To report the Treasury Management activities of the Council 2018/19.


## Recommendations

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

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**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 CIPFA Code of Practice on Treasury Management in Local Authorities. The City Council has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Chief Financial Officer responsibilities, and delegation and reporting arrangements. This was approved by the Council on 2 March 2018 as part of the Treasury Management Strategy Statement for 2018/19.

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 5th November 2018, 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:

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| Section 1: | Introduction and Background |
| Section 2: | The Council's Portfolio Position as at 31st March 2019 |
| Section 3: | Borrowing Strategy for 2018/19 |
| Section 4: | Borrowing Activities in 2018/19 |
| Section 5: | Compliance with Prudential Indicators and Treasury Limits |
| Section 6: | Investment Strategy for 2018/19 |
| Section 7: | Temporary Borrowing and Investment Outturn for 2018/19 |
| Section 8: | Conclusion |
| Appendix 1: | PWLB Interest Rates |
| Appendix 2: | Treasury Management Prudential Indicators |
| Appendix 3: | Glossary of Terms |

## 2 The Council's Portfolio Position as at 31st March 2019

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. There was borrowing of £150.0m from Public Works Loan Board (PWLB) in the year.

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

| Loan Type | 31 March 2018 | | | | 31 March 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | GF | HRA | Principal | Average Rate | GF | HRA | Principal | Average Rate |
| | £m | £m | £m | % | £m | £m | £m | % |
| | | | | | | | | |
| PWLB | 0.0 | 0.0 | 0.0 | 0.00 | 150.0 | 0.0 | 150.0 | 2.45 |
| Temporary Borrowing | 0.9 | 0.0 | 0.9 | 0.50 | 4.9 | 0.0 | 4.9 | 0.75 |
| Market Loans | 378.5 | 69.7 | 448.2 | 4.75 | 338.0 | 62.2 | 400.2 | 4.50 |
| Stock | 0.9 | 0.0 | 0.9 | 4.00 | 0.9 | 0.0 | 0.9 | 4.00 |
| Government Lending | 80.3 | 0.0 | 80.3 | 0.00 | 52.0 | 0.0 | 52.0 | 0.00 |
| **Gross Total** | **460.6** | **69.7** | **530.3** | **4.02** | **545.8** | **62.2** | **608.0** | **3.58** |
| | | | | | | | | |
| Housing Investment Fund (HIF) Temporary Borrowing | | | | | 118.8 | 0.0 | 118.8 | 0.00 |
| | | | | | | | | |
| Temporary Deposits | (137.9) | 0.0 | (137.9) | (0.35) | (80.6) | 0.0 | (80.6) | 0.64 |
| Internal Balances (GF/HRA) | 37.0 | (37.0) | 0.00 | 0.00 | 35.4 | (35.4) | 0.00 | 0.00 |
| | | | | | | | | |
| **Net Total** | **359.7** | **32.7** | **392.4** | **-** | **619.4** | **26.8** | **646.2** | **-** |
| | | | | | | | | |

2.3 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 Greater Manchester Combined Authority (GMCA) did not have the relevant borrowing powers to be able to hold the Government funding for the activity. During 2018/19 the GMCA received these powers and therefore the debt from Government relating to the HIF was novated from the City Council to the GMCA, with £197.7m transferring on the 13 March 2019. The process of novating the HIF investments has begun, but none had novated as at 31 March 2019, and the Council therefore held £118.8m of investments supported through an interest free loan from the GMCA to the City Council, as shown in the table above.

2.4 The HIF debt novation, alongside the capital activity of the City Council, has required that the Council support the cash flow through external borrowing. On the 31 January 2019, the Council borrowed £150m from the Public Works Loan Board (PWLB).

2.5 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.

2.6 At 31 March 2019 Government lending included £36m from the Homes England in relation to land receipts to be used to support housing initiatives, and £16m from Salix for energy schemes.

2.7 An assumed borrowing need of £360m was identified in the budget for 2018/19. However, further additional borrowing beyond that noted above was not required in the year, which is due to positive changes in working capital and the profile of capital spend changing from that set at budget.

2.8 Several local public sector organisations invest funds with the Council in order reduce counterparty risk and to achieve an investment return. The Council has borrowed £4.8m in this way, which is deemed to be temporary borrowing due to the type of facility offered.

## 3 Borrowing Strategy for 2018/19

3.1 The treasury strategy continues to be a balance between postponing borrowing to avoid the cost of investing higher levels of cash and reduce counterparty risk, and taking borrowing to 'lock-in' long term borrowing at historically low rates and mitigate against the risk of delaying and borrowing at higher rates.

3.2 The expectation for interest rates within the 2018/19 strategy was informed by the Authority's external Treasury Advisors. Link Asset Services expected Bank Rate to rise to 0.75% by March 2019. The Bank of England did in fact increase Bank Rate to 0.75% from 0.50% on the 2nd August 2018. Despite the rise in Bank Rate the assumption that variable or short-term rates were expected to be the cheaper form of borrowing over the period remained valid. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

## 4 Borrowing Activities in 2018/19

4.1 During the financial year the Council borrowed a total of £164.9m of the assumed borrowing need of £360m identified in the budget. The borrowing need became lower throughout the year because of favourable movements in the levels of receipts and payments. The sources of the borrowing taken are discussed below.

**PWLB**

4.2 PWLB interest rates have fluctuated during the year as shown in the summary table below and in the graph attached at Appendix A.

| PWLB Borrowing Rates 2018/19 for 1 to 50 years | | | | | |
|---|---|---|---|---|---|
| | **1 Year** | **5 Years** | **10 Years** | **25 Years** | **50 Years** |
| Low | 1.48% | 1.70% | 2.00% | 2.53% | 2.36% |
| *Date* | *01/06/2018* | *28/03/2019* | *28/03/2019* | *26/03/2019* | *26/03/2019* |
| High | 1.84% | 2.27% | 2.70% | 3.13% | 2.99% |
| *Date* | *10/10/2018* | *10/10/2018* | *10/10/2018* | *10/10/2018* | *12/10/2018* |
| Average | 1.70% | 2.00% | 2.39% | 2.85% | 2.66% |

4.3 After 1 November 2012 the Government, reduced the interest rates by 0.20% on loans from the PWLB to local authorities who provide information to Government on their plans for long-term borrowing and associated capital spending. The City Council provided the required information, and can therefore access this Certainty Rate.

4.4 The £150m PWLB borrowing in the year was taken at the more favourable Certainty Rate. Six tranches of £25m have been taken each with maturities between 37.5 years and 42.5 years.

**Homes and Communities Agency (HCA)**

4.5 The HCA has made funding available to Greater Manchester (GM), which is in effect a ‘loan’ of the HCA’s receipts from the disposal of its land and property within GM. The funds can be used to invest in any project which supports GM City Deal objectives. Some of the funds will be passed on to GM authorities for projects within their areas. The funds received are classified as loans as they will be repaid to the HCA in March 2022, however no interest is charged by the HCA on the advances.  The Council hosts this arrangement on behalf of GM and the funds are to be used for housing or commercial projects within GM. It is expected that the receipts will be novated to the GMCA in 2019/20.

4.6 In the year the Council received a further £2.4m of HCA funding. Further funds are expected to be called down against these arrangements from 2019/20 onwards. The funding from the HCA is held as an interest free loan, until such time as an investment approval is made. At this point, the approved element of the loan becomes risk-based, with the return to the HCA based on the performance of that investment.

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

**Housing Investment Funding (HIF)**

4.8 As noted above, on 13 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. This amounted to £118.8m at 31 March 2019.

**Salix Borrowing**

4.9 In the year the Council received £12.5m of this funding which was recorded as a loan at 31 March 2019. Salix Finance Ltd provides interest-free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The advance was received in respect of specific Council projects and will be repaid by 1 April 2023.

## 5 Compliance with Prudential Indicators and Treasury Limits

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

5.2 The breaches of the Council's daily £400k limit on the Barclays Current Account can be grouped under three main areas:

i. On four occasions Treasury Management staff had not been advised of expected specific receipts or payments, 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 or from the Call Account to remain within limits.

ii. On two occasions Treasury Management breached the £400k limit due to failures in treasury management processes. Measures have been put in place to strengthen procedures and help prevent future errors occurring.

iii. On one occasion Treasury Management was subject to online fraud. Further investigation and action is ongoing to recover the funds. Electronic fraud is unfortunately growing significantly and additional security measures have been put in place to better detect and prevent any future fraudulent activities directed towards the Council.

5.3 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 Investment Strategy for 2018/19

6.1 The Treasury Management Strategy Statement (TMSS) for 2018/19 was approved by the Executive Committee on 7 February 2018, and by Council on 2 March 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 The Council's temporary cash balances are 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.

6.3 During the year in order to increase flexibility and further improve liquidity the Council started to use Money Market Funds (MMFs), as approved as part of the 2018/19 Treasury Management Strategy Statement. Money Market Funds are investment instruments that invest in a variety of institutions, therefore diversifying the investment risk. The funds are managed by a fund manager and they have objectives to preserve capital, provide daily liquidity and a competitive yield. Investing in the Funds has been beneficial to the Council because the interest rates on the Funds have been competitive in comparison to other deposit options available to the Council.

6.4 Four MMFs are initially being used and these have been selected and their use approved in accordance with the requirements set out in the TMSS.

## 7 Temporary Borrowing and Investment Outturn 2018/19

7.1 Investment rates available in the market continue to be at a low point. The average level of funds available for investment purposes in 2018/19 was just over £138m. 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.

7.2 Temporary borrowing consists of funds the Council holds for Manchester organisations that work closely with the Council. It was agreed the Council would pay interest on their funds in line with the base rate.

7.3 The average level of temporary borrowing during the financial year was £3.8m.

7.4 Detailed below is the temporary investment and borrowing undertaken by the Council. As illustrated, the Council over performed the benchmark by 6 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.

| | Average temporary Investment /borrowing | Net Return/Cost | Benchmark Return / Cost * |
|---|---|---|---|
| Temporary Investments | £138.3m | 0.57% | 0.51% |
| Temporary Borrowing | £3.8m | 0.68% | 0.63% |

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

7.5 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.

## 8 Conclusion

8.1 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 decreased in 2018/19, and in the year long term borrowing of £150.0m was secured from the PWLB to strengthen the Council's balance sheet position.

8.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.57%, which is higher than the benchmark average 7-day LIBID rate of 0.51%. There was an average net cost of temporary borrowing of 0.68%, higher than the benchmark average 7-day LIBOR rate of 0.63%, which is predominantly due to the terms the Council has offered to other public sector bodies (referenced at paragraph 2.8 above) being linked to Bank of England base rate rather than LIBOR.

8.3 Based on the current cash flow forecast, it is expected that the Council will need to borrow further funds during the 2019/20 financial year. This will be dependent on cash flow movements and changes in working capital throughout the year, which will be monitored. All available borrowing options will be considered, as per the Treasury Management Strategy Statement for 2019/20.