Manchester City Council
Report for Information

Report to: Audit Committee – 12 November 2019

Subject: Treasury Management Interim Report 2019-20

Report of: Deputy Chief Executive and City Treasurer

Summary

To report the Treasury Management activities of the Council during the first six months of 2019-20.

Recommendations

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

Wards Affected: Not Applicable

Contact Officers:

Name: Carol Culley
Position: Deputy Chief Executive and City Treasurer
Telephone: 0161 234 3406
E-mail: c.culley@manchester.gov.uk

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

Name: Tim Seagrave
Position: Group Finance Lead – Capital and Treasury Management
Telephone: 0161 234 3445
E-mail: t.seagrave@manchester.gov.uk

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

Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

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 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 2017 and this report has been prepared in accordance with the revised Code. The sections of this report are shown below:

Section 1:	Introduction and Background
Section 2:	The Council's Portfolio Position as at 30th September 2019
Section 3:	Review of Economic Conditions
Section 4:	External borrowing in 2019-20 to date
Section 5:	PWLB policy change
Section 6:	Compliance with Treasury Limits and Prudential Indicators
Section 7:	Investment Strategy for 2019-20 to date
Section 8:	Temporary Borrowing and Investment for 2019-20 to date
Section 9:	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 Portfolio Position as at 30th September 2019

2.1 As outlined in the approved Treasury Management Strategy for 2019-20 it is anticipated that there will 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. 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 some borrowing is likely to be required during the second half of the year.

2.2 The Council's debt position at the beginning of the financial year and at the end of September is compared in the table below:

Loan Type	31 March 2019				30 September 2019			
			Principal	Avg.			Principal	Avg.
	GF	HRA		Rate	GF	HRA		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	2.1	0.0	2.1	0.99
Market Loans	338.0	62.2	400.2	4.50	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	52.0	0.0	52.0	0.00	55.0	0.0	55.0	0.00
Gross Total	**545.8**	**62.2**	**608.0**	**3.58**	**546.0**	**62.2**	**608.2**	**3.57**
Housing Investment Fund (HIF) Temporary Borrowing	118.8	0.0	118.8	0.00	131.4	0.0	131.4	0.00
Temporary Deposits	(137.9)	0.0	(137.9)	(0.35)	(109.9)	0.0	(109.9)	0.73
Internal Balances (GF/HRA)	37.0	(37.0)	0.00	0.00	43.3	(43.3)	0.0	0.00
Net Total	**619.4**	**26.8**	**646.2**	**-**	**610.8**	**18.9**	**629.7**	**-**

2.3 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.

2.4 Total debt has slightly increased by £0.2m during the period 31st March 2019 to 30th September 2019. The increase was mainly due to the receipt of £3.0m Salix loan on the 8th of August 2019, which was partially offset by the repayment of £2.8m of Manchester International Festival temporary loan gradually throughout the period.

2.5 An assumed borrowing need of £145.6m was identified in the budget for 2019-20 and based on the current cash flow forecast the estimated borrowing requirement is now c.£110.2m. This includes the assumption that the Housing Investment Fund (HIF) borrowing will unwind by the end of the financial year. 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.

2.6 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 2019-20. If any borrowing is taken during it will be reported at outturn.

3 Review of Economic Conditions: April to date 2019

3.1 The Bank of England maintained the lending rate at 0.75% in the first half of the financial year. In August 2018 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.

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

4 Treasury Borrowing in 2019-20 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 A.

PWLB Borrowing Rates 2019-20 to date for 1 to 50 years					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.37%	1.21%	1.33%	1.93%	1.77%
Date	03/09/2019	03/09/2019	03/09/2019	03/09/2019	03/09/2019
High	1.78%	1.93%	2.27%	2.78%	2.61%
Date	15/04/2019	17/04/2019	17/04/2019	17/04/2019	03/05/2019
Average	1.60%	1.57%	1.83%	2.41%	2.27%

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.

Homes and Communities Agency (HCA)

4.3 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 by the end of 2019/20.

Housing Investment Funding (HIF)

4.4 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 £131.4m at 30th September 2019.

Salix Borrowing

4.5 In the first half of the year Council received £3.0m of this funding which was recorded as a loan on the 8th of August 2019, bringing the total to £18.6m. 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 2025.

5 PWLB policy change

5.1 The Council has access to the Public Works Loan Board (PWLB) for debt, which is an executive agency of the Treasury. Acting as a lender to the local authority sector, it provides debt at interest costs linked to the equivalent debt costs of Government, known as Gilts.

5.2 The PWLB published twice daily the standard rates available to local authorities for loans. The interest rate methodology is complex, but roughly equates to the equivalent of Gilts plus 100 basis points. This means that if the 20 year Gilt was 2.50% the Council would expect the PWLB rate to be 3.50%.

5.3 The City Council, by virtue of providing Government with information around expected borrowing and capital expenditure, has access to the certainty rate, which provides a discount of around 20 basis points on the standard rate or the equivalent of Gilts plus 80 basis points.

5.4 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 the Council already hold have not changed.

5.5 Treasury have taken this step as there had been a significant increase in local authority borrowing in recent months, driven by interest rates falling. As local authority debt forms part of the national debt, and amidst concern about local authorities investing in commercial assets in order to profit from the return, by increasing the interest cost Treasury want the demand for debt to fall.

5.6 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 this year.

5.7 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.

5.8 The impact of the change on the Council's capital programme are detailed in a report which was submitted to the Resources and Governance Scrutiny Committee on the 5th of November.

5.9 Increasing the interest rate on PWLB debt creates an additional margin above Gilts which means that other institutions involved in financial markets may now be able to provide local authorities with debt solutions. Previously the relatively low level of Gilts meant other market participants could not easily find financial products for local authorities which could provide value for money. The increased margin on PWLB debt provides them with an opportunity which may allow the Council to borrow at rates below PWLB, but at the time of writing this report this market is still forming and therefore the availability of debt at such rates is still to be determined.

5.10 Once there is clarity on what financial markets may be able to offer, there will be a need to review the Council's borrowing strategy. There may be a case, for example, of looking to borrow for shorter duration and therefore at lower rates, if the Council feels this will provide value for money and is willing to accept the refinancing risk that this would create.

6 Compliance with Treasury Limits and Prudential Indicators

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, 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 eleven 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.

6.3 During the period 1st April to 30th September 2019 there were eleven breaches of the daily £0-400k limit on the Barclays current account.

i. On five occasions, they were due to HIF receipts. Such receipts require legal completions to be actioned, which means that their timing is unpredictable, resulting in income being received very late in the day. All HIF loans are planned to either novate across to GMCA or mature by the end of the financial year.

ii. On four occasions they were due to various large receipts arriving late in the afternoon which Treasury Management had not been informed about. Reminders have been sent to teams to keep Treasury Management well informed of both payments and receipts over £100k.
iii. On one occasion a payment bounced back late in the afternoon due to the use of old bank details. This has been discussed with the Finance Shared Service to seek to try to prevent it happening again.
iv. On the final occasion, Treasury Management kept the account in surplus as a precaution to avoid an overdrawn account as an expected direct debit payment had not occurred, and it was expected it would be taken late in the afternoon.

6.4 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. No additional costs arose as a result, other than the opportunity cost incurred of not investing the surplus cash.

7 Investment Strategy for 2019-20 to date

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 Previously action has been taken to open four MMF accounts, and the Council has now opened a fifth with CCLA, an investment firm which manage funds for charities and the public sector.

7.4 The current strategy means that a significant proportion of the Council's investments are with 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.

7.5 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.

7.6 During the financial year to date 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 2019-20 to date

8.1 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 2019-20 was £78.9m. 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.

8.2 The temporary investment and borrowing undertaken by the Council is detailed below. As illustrated, the Council over performed the benchmark by 15 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.

8.3 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, unless agreed otherwise.

	Average temporary investment/borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£78.9m	0.72%	0.57%
Temporary Borrowing	£4.2m	0.84%	0.69%

** Average 7-day LIBID/LIBOR rates*

8.4 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 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 based on current forecasts a borrowing requirement is expected during the second half of 2019-20.

9.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.72%, in excess of the benchmark average 7-day LIBID rate of 0.57% 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.

9.3 The change in policy for the PWLB has challenged the local authority debt environment, and it is anticipated that it will take some time before the market settles on debt terms for local authorities. Officers will actively monitor the market, and engage with market participants including banks, investment firms, brokers and advisors to review the debt opportunities available to the Council.