**Manchester City Council**
**Report for Resolution**

**Report to:** Executive – 16 February 2022
Resources and Governance Scrutiny Committee – 28 February 2022
Council – 4 March 2022

**Subject:** Treasury Management Strategy Statement 2022/23, including Borrowing Limits and Annual Investment Strategy

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

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## Summary

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2022/23 and Prudential Indicators for 2022/23 to 2024/25.


## Recommendations

The Executive is requested to:-

(1) Recommend the report to Council.

(2) Delegate authority to the Deputy Chief Executive and City Treasurer, in consultation with the Member of Executive with responsibility for Finance and HR, to:
- approve changes to the borrowing figures as a result of changes to the Council's Capital or Revenue budget; and
- submit these changes to Council.

The Resource and Governance Scrutiny Committee is requested to:-

(1) Recommend the report to Council.

The Council is requested to:-

(1) Approve the proposed Treasury Management Strategy Statement, the:
- Borrowing Requirement listed in Section 7 of this report;
- Borrowing Strategy outlined in Section 10;
- Annual Investment Strategy detailed in Section 11;
- Prudential and Treasury Indicators listed in Appendix A;
- MRP Strategy outlined in Appendix B;
- Treasury Management Policy Statement at Appendix C; and
- Treasury Management Scheme of Delegation at Appendix D

(2) Delegate to the Deputy Chief Executive and City Treasurer, in consultation with the Member of Executive with responsibility for Finance and HR, the power to pursue any restructuring, rescheduling or redemption opportunities available,

including amendments to the Treasury Management Strategy if the changes require it. Any changes required to the Strategy will be reported to members at the earliest opportunity.

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**Wards Affected -** All

| **Environmental Impact Assessment** - the impact of the decisions proposed in this report on achieving the zero-carbon target for the city |
|---|
| Treasury Management activity underpins the Council's finances, and therefore supports projects and initiatives which seek to achieve the Council's zero carbon target. |

| Our Manchester Strategy outcomes | Contribution to the strategy |
|---|---|
| A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities | The Treasury Management function supports the whole Council by seeking to ensure that funding is available when required, to fund all the work that the Council undertakes. Therefore, whilst not directly contributing to the strategic aims, the Council's treasury management activity underpins the work taking place elsewhere to achieve the outcomes. |
| A highly skilled city: world class and home-grown talent sustaining the city's economic success | |
| A progressive and equitable city: making a positive contribution by unlocking the potential of our communities | |
| A liveable and low carbon city: a destination of choice to live, visit, work | |
| A connected city: world class infrastructure and connectivity to drive growth | |

**Full details are in the body of the report, along with any implications for**

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

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**Financial Consequences – Revenue**

The capital financing budget forms a key part of the Council's revenue budget. The activity forecast in this report is affordable within the existing and future capital financing budget, including use of the capital financing reserve.

**Financial Consequences – Capital**

None – the Council's treasury management activity is not capital expenditure.

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**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.

- Capital Strategy and Budget 2022/23 - 2025/26 report to Executive 16 February 2022
- CIPFA Prudential Code 2021
- CIPFA Treasury Management Code of Practice 2021

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.

## 1 Introduction

1.1 The Treasury Management Strategy Statement sets out the risk framework under which the Council's treasury management function will operate. By detailing the investment and debt instruments to be used during the year the Strategy details the risk appetite of the Authority and how those risks will be managed.

1.2 The Treasury Management Strategy Statement is linked to the Capital Strategy, in that both documents detail the risks that the Council face, but critically the Treasury Management Strategy Statement is focussed on the risks associated with the management of the Council's cash flow and debt, whereas the Capital Strategy looks at capital investment and expenditure decisions.

1.3 The capital budget contains significant priorities for the Council, such as the refurbishment of the Town Hall, which are to be funded from borrowing. This strategy details how decisions will be taken regarding new borrowing and that the over-arching principle is that the borrowing provides value for money for the Council in whatever form it takes. Capital investment decisions are made in line with the economic and regeneration objectives for the city and to support delivery of the agreed capital strategy.

1.4 For treasury management investments the Council holds security and liquidity as paramount. This strategy proposes the use of investment types aimed at ensuring that funds are kept secure and that the Council has access to funds when they are required.

1.5 The work of the Council's treasury management function is impacted by market conditions and significant economic changes, such as the COVID-19 Pandemic, which create uncertainty in the market. The strategy has been drafted to provide flexibility to manage the risks associated with uncertainties such as interest rate or liquidity challenges.

***Treasury Management Strategy for 2022/23***

1.6 The suggested strategy for 2022/23 is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, Link Asset Services.

The strategy covers:

| | |
|---|---|
| Section 1: | Introduction |
| Section 2: | CIPFA Definition of Treasury Management |
| Section 3: | Statutory and other Requirements |
| Section 4: | Prudential and Treasury Indicators for 2022/23 to 2024/25 |
| Section 5: | Impact of 2012 HRA reform |
| Section 6: | Current Portfolio Position |
| Section 7: | Prospects for Interest Rates |
| Section 8: | Borrowing Requirement |
| Section 9: | Borrowing Strategy |

## 2 CIPFA Definition of Treasury Management

2.1 Treasury management is defined by CIPFA as:
'The management of the organisation's borrowing, investments and cash flows, including 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.'

## 3 Statutory and other requirements

***Statutory requirements***

3.1 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

3.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as section 11 of this report); the Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 The Department for Housing, Communities and Local Government (DHCLG) issued revised investment guidance which came into effect from the 1 April 2010. In 2017 the Department, now the Ministry of Housing Communities and Local Government (MHCLG) further updated its guidance on local government investments. CIPFA responded to these revisions by issuing an updated Code of Practice on Treasury Management and the Prudential Code in 2021.

### *CIPFA requirements*

3.4 The CIPFA Code of Practice on Treasury Management has been adopted by the Council. This strategy has been prepared in accordance with the revised December 2021 Code.

3.5 The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
b) Creation and maintenance of Treasury Management Practices which set out the way the Council will seek to achieve those policies and objectives;
c) Receipt by the full Council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year;
d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;
e) Delegation by the Council of the role of responsible body for treasury management strategy and practices, budget consideration and approval, monitoring and selection of external service providers to a specific named body. For this Council the delegated body is the Audit Committee.
f) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Resource and Governance Scrutiny Committee.

3.6 The Council's adherence to the Prudential Code is monitored through the series of Prudential Indicators defined by CIPFA. Adherence to the CIPFA Prudential Code is a factor which informs the Council's investment policy. The legal status of the Treasury Management Code is derived in England and Wales from regulations issued under the Local Government Act 2003. This includes statutory guidance on Local Government investments issued under section 15(1) (a) of the Act.

### *Balanced Budget Requirement*

3.7 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. Section 31 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure;
- increases to the minimum revenue provision; and

- increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

## 4 Prudential and Treasury Indicators for 2022/23 to 2024/25

4.1 It is a statutory duty under Section 3 of the Act and supporting regulations that the Council determines and keeps under review how much it can afford to borrow. This amount is termed the ‘Affordable Borrowing Limit’. In England this Authorised Limit represents the legislative limit specified in the Act and is one of the key Prudential Indicators identified by the CIPFA Code.

4.2 The Council must have regard to the Prudential Code when setting the Authorised Limit which requires it to ensure that total capital investment remains within sustainable limits.

4.3 Whilst termed an Affordable Borrowing Limit, the capital plans incorporate financing by both external borrowing and other forms of liability such as credit arrangements. The Authorised Limit is to be set on a rolling basis for the forthcoming financial year and two successive financial years.

4.4 The full set of Treasury limits and Prudential Indicators recommended by the Code and used by the Council, together with their suggested levels for 2022/23 is noted in Appendix A of this report.

4.5 It should be noted that the Prudential and Treasury Indicators in this report may be subject to change dependent on decisions taken on the Capital and Revenue budgets which are reported elsewhere on this agenda.

## 5 The Housing Revenue Account – Impact of 2012 HRA Reform

5.1 The Local Government Finance and Housing Act 1989 requires Councils who own housing they rent out to tenants to separate all the financial activities relating to the Council acting as landlord into a ring-fenced account known as the Housing Revenue Account (HRA). Due to the ring-fence it is illegal for the Council to subsidise any General Fund (GF) activity from its HRA and vice versa.

5.2 The Treasury Management Strategy for 2013/14 was the first to incorporate the split of the Council’s debt portfolio following the HRA debt settlement of March 2012 which ended the subsidy arrangement. Details of how the split was calculated and the corresponding effect on treasury management activities are at Appendix I.

5.3 The treasury position of the Council will continue to be monitored at a Council level alongside the separate positions for the GF and the HRA. The HRA is also limited in terms of the treasury activity it can undertake as any temporary borrowing or investing it requires or long-term borrowing will be through the GF. This ensures that the overall Council position is managed as effectively and efficiently as possible.

5.4 To reflect the fact that the HRA now has its own treasury position this report will mention where the HRA treasury strategy may be different to that of the GF. Where the Council strategy is mentioned this applies to both the GF and the HRA.

## 6 Current Portfolio Position

6.1 The forecast portfolio position for the end of the current financial year is shown below. The short term borrowing taken during the pandemic has been refinanced with long term debt from the PWLB, with further PWLB taken to fund the capital programme.

6.2 The Council's forecast treasury portfolio position at 31st March 2022 is:

| **Table 1** | **Principal** | | | **Av Rate** |
|---|---|---|---|---|
| | GF | HRA | **Total** | |
| | £'m | £'m | **£'m** | % |
| **Long Term Borrowing** | | | | |
| PWLB | 400.0 | 0.0 | **400.0** | 2.00 |
| Market | 334.3 | 61.4 | **395.7** | 4.47 |
| Stock | 0.9 | 0.0 | **0.9** | 4.00 |
| SALIX | 10.9 | 0.0 | **10.9** | 0.00 |
| HCA | 8.4 | 0.0 | **8.4** | 0.00 |
| | 754.5 | 61.4 | **815.9** | |
| **Short Term Borrowing** | | | | |
| Other | 10.6 | 0.0 | **10.6** | 0.34 |
| **Gross Debt** | 765.1 | 61.4 | **826.5** | 3.11 |
| | | | | |
| External Investments | (41.1) | 0.0 | **(41.1)** | 0.10 |
| | | | | |
| Internal Balances (GF/HRA) | 48.0 | (48.0) | **0** | 0.00 |
| | | | | |
| **Net Debt** | **772.0** | **13.4** | **785.4** | |
| | | | | |
| Capital Financing Requirement | | | 1,784.4 | |
| Gross Debt | | | 826.5 | |
| Other Long-Term Liabilities | | | 155.2 | |
| Internal Borrowing | | | **802.7** | |

6.3 The Capital Financing Requirement measures an Authority's underlying need to borrow or finance by other long-term liabilities for a capital purpose. It represents the amount of capital expenditure that has not yet been resourced absolutely, whether at the point of spend (by capital receipts, capital grants/contributions or from revenue income), or over the longer term by prudent Minimum Revenue Provision (MRP) or voluntary application of capital receipts for debt repayment etc. Alternatively, it provides a figure for the capital expenditure incurred by the Council but not yet provided for.

6.4 The Capital Financing Requirement of the City Council as at 31st March 2022 is forecast to be c. £1,.8bn. The difference between this and the actual gross debt of the Council is c. £0.8bn which is the amount of funding that the Council has internally borrowed or has been funded through credit arrangements. This reflects the Council's ongoing treasury strategy of using internal cash to reduce the amount of borrowing required rather than holding this cash as investments.

6.5 This strategy reflects the current environment where the rate of interest on investments is significantly lower than that on borrowing and there are substantial counterparty risks, this has been a prudent approach and has provided value for money for the Council. Internal cash refers to cash surpluses which arise from holding of reserves and timing of receipts and payments.

6.6 As part of the reform of the HRA, on the 28th March 2012 the then DHCLG repaid all the Council's Public Works Loan Board (PWLB) debt which had been gradually reduced over recent years by various housing stock transfers. Subsequently the HRA debt portfolio consists almost exclusively of market debt, the majority of which are Lender Option Borrower Option (LOBO) loans which have long-term maturity dates. Whilst this provides some stability for the Council as LOBOs are unlikely to be called in the near future due to the current and forecast market environment, it does mean that when seeking to take new debt the Council should consider diversifying the portfolio, not least to ensure a wider range of maturity dates.

6.7 The portfolio at 31st March 2022 includes Council Stock with a value of £0.9m. This Stock debt is attributable to the irredeemable class of stock where stockholders have not taken up the Council's redemption offer made in 2017/18.

## 7 Prospects for Interest Rates

7.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix G draws together several current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following gives Link's central view for interest rates at financial year ends (March):

- 2022: 0.25%
- 2023: 0.75%
- 2024: 1.00%

7.2 There is no certainty to these forecasts. A detailed view of the current economic background prepared by Link Asset Services is at Appendix F to this report.

7.3 The Council seeks to maintain a portfolio of debt and investments that is a mix of fixed and variable interest rates. Whilst fixed interest rates give the Council certainty, there is also a risk that prevailing market rates change and there are then opportunities to either increase the rate of return on investments or reduce the rate of interest on debt which could not be taken if the whole portfolio was fixed.

7.4 The Council's treasury management investments are classed as variable as the Council invests short term to enable the cash flow to be managed. In terms of debt, the Council has a significant portfolio of fixed rate debt, but as noted above a significant element of this is LOBO debt which means that there are risks that the interest rate on that debt could change. The Council monitors this position, including the likely use of the Lender Options, and will make future borrowing decisions with a view to keeping the debt portfolio balanced between fixed and variable debt.

## 8 Borrowing Requirement

8.1 The potential long-term borrowing requirements over the next three years are:

| **Table 2** | **2022/23** | **2023/24** | **2024/25** |
|---|---|---|---|
| | **£'m** | **£'m** | **£'m** |
| | **estimate** | **estimate** | **estimate** |
| Planned Capital Expenditure funded by Borrowing | 346.0 | 144.8 | 48.1 |
| | | | |
| Change in Grants & Contributions | 41.0 | 38.1 | 0.0 |
| Change in Capital Receipts | 1.1 | (43.3) | (12.9) |
| Change in Reserves | 68.8 | 53.8 | 28.7 |
| MRP Provision | (32.9) | (39.3) | (40.8) |
| Refinancing of maturing debt (GF) | 8.3 | 3.7 | 10.8 |
| Refinancing of maturing debt (HRA) | 0.8 | 0.0 | 0.0 |
| Movement in Working Capital | 165.2 | 0.0 | 0.0 |
| | | | |
| **Estimated Borrowing Requirement** | **598.3** | **157.8** | **33.9** |
| Funded by: | | | |
| GF | 596.4 | 157.8 | 33.9 |
| HRA | 0.8 | 0.0 | 0.0 |
| | | | |

## 9 Borrowing Strategy

### *General Fund*

9.1 Following the HRA debt settlement in 2012 the Council's debt position is one of significant internal borrowing meaning cash backed reserves and provisions are being used in lieu of external debt. The external debt held is predominantly long term in nature.

9.2 The proposed Capital Budget, submitted to Executive in February and Council in March, contains significant capital investment across the city. The scale of the investment will mean that the Council will need to undertake external borrowing in the future and will not be able on to rely on internal borrowing alone. Where possible, internal borrowing will remain the first option due to the interest savings generated.

9.3 To this aim, the Council's borrowing strategy will utilise the annual provision it is required to make to reduce debt, in the form of its Minimum Revenue Provision (MRP). If MRP is not used to reduce external debt it is held as cash, so the most efficient arrangement is for MRP to be used to reduce the new long-term debt expected to be required. This ensures that MRP is utilised and does not accumulate as cash on the Balance Sheet. Alternatively, MRP could be used to repay existing debt but this would be at considerable cost in the current interest rate environment.

9.4 Beyond the forecast period for capital investment and matching to the same principles as above, a prudent strategy is to seek to borrow in the medium term with maturities to match the estimated MRP that is generated in the same period. This avoids an accumulation of cash on the Balance Sheet that would need to be invested at a potential net cost and investment risk to the Council.

9.5 The overall strategy is therefore for the Council to continue to use reserves and provisions to maximise internal borrowing whilst seeking to rebalance the portfolio with more medium-term debt when there is a need to externally borrow. This must be done with a strong focus on achieving value for money on interest costs and balancing the risks to the overall debt portfolio over the long term.

### *HRA*

9.6 The Council's proposed capital budget for 2022/23 and beyond does not contain any requirement for the HRA to borrow additional sums. It is expected that proposals may be brought forward that require funding via borrowing, which would create a borrowing requirement for 2022/23 or future years. The level of borrowing affordable is restrained by the statutory requirement for the HRA Business Plan to avoid going into a deficit, and as such any long term borrowing that is taken to invest in capital assets would have to generate sufficient income to cover the costs of financing the debt, and be supported by a sufficiently robust business case.

9.7 The impact of any required further long-term borrowing on the Business Plan will be reviewed which will inform the borrowing options pursued. Any temporary borrowing required will be sought from the General Fund, as per the pooled funding approach which is discussed further in Appendix I.

9.8 Note, if some of the current debt is required to be repaid, for example if one of the LOBO loans was called, the refinancing arrangements would need to be considered.

***Borrowing Options***

9.9 The overall forecast for long-term borrowing rates is that they are expected to rise gradually during 2022/23 and will continue to increase in future years from their historically low levels. In terms of the Council's borrowing strategy there are three options:

i. Internal borrowing
ii. Short to medium term borrowing
iii. Long term borrowing

The Treasury Management team will continue to monitor and manage the risk of each of the above borrowing options. At such time the Council will need to borrow, the debt market will be actively monitored and the borrowing strategy which delivers the optimum value for money will be chosen. The short-term advantage of internal and short-term borrowing will be weighed against the potential cost if long term borrowing is delayed.

9.10 New borrowing will be considered in the forms noted below. All options will be evaluated alongside their availability and which provides best value for money. The options below are not presented in a hierarchical order.

- **Public Works Loan Board (PWLB)**

In February 2020 Parliament reformed the statutory basis of the PWLB, transferring lending powers to HM Treasury. In March 2020 the government consulted on revising the PWLB's lending terms to reflect the new governance arrangements as well as to end the situation in which a minority of local authorities used PWLB loans to fund debt for yield activity via commercial investments. The government published its response to this consultation and implemented these reforms in November 2020.
Additional requirements to borrow from PWLB were introduced. Each local authority that wishes to borrow from the PWLB will need to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. Any investment assets bought primarily for yield will not be supported by PWLB.
Local Authorities will be asked to:

i. Categorise Capital Spending into: Service Spending, Housing, Regeneration, Preventative Action, Treasury Management, and Debt for Yield activity.

ii. Provide a short description covering at least 75% of the spending in each category.
iii. Provide assurance from the section 151 officer or equivalent that the local authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield.

PWLB borrowing is available between 1- and 50-year maturities on various bases. This offers a range of options for new borrowing which could spread debt maturities away from a concentration in longer dated debt and allow the Council to align maturities to MRP.

In the last 12 months, the UK Infrastructure Bank has launched which is independent of HM Treasury, and which aims to lend to local authorities for strategic and high value projects alongside the private sector. One of the access routes to the bank is through the PWLB, and the Council would evaluate this option if it is available.

The Link forecast for the PWLB Certainty Rate is as follows:

| **Table 3** | **Mar 22** | **Jun 22** | **Sep 22** | **Dec 22** | **Mar 23** | **Mar 24** | **Mar 25** |
|---|---|---|---|---|---|---|---|
| | % | | | | | | |
| Bank Rate | 0.25 | 0.50 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 |
| 5 yr PWLB rate | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.90 | 2.00 |
| 10 yr PWLB rate | 1.70 | 1.80 | 1.80 | 1.90 | 1.90 | 2.10 | 2.30 |
| 25 yr PWLB rate | 1.90 | 2.00 | 2.10 | 2.10 | 2.20 | 2.30 | 2.50 |
| 50 yr PWLB rate | 1.70 | 1.80 | 1.90 | 1.90 | 2.00 | 2.10 | 2.30 |

A more detailed Link forecast is included in Appendix G to this report.

- **European Investment Bank (EIB)**

Historically, the EIB rates for borrowing were generally favourable compared to PWLB although the margin of benefit has now reduced as a result of the U.K. withdrawing from the EU and the reversal of PWLB rates as described above. The Council still has access to EIB along with the option to forward fix rates for borrowing and this option will be considered if the conditions can be met and it offers better value for money. The EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, and any monies borrowed are part of the Council's overall pooled borrowing.

- **Third Party Loans**

These are loans from third parties that are offered at lower than market rates, for example Salix Finance Ltd is offering loans to the public sector at 0% to be used specifically to improve their energy efficiency and reduce carbon emissions.

- **Inter-Local Authority advances**

Both short- and medium-term loans are often available in the inter Local Authority market.

- **Market Loans**

Following the reversal of the PWLB rates noted above, there has been a decrease in market activity relating to local authority debt as the debt pricing and structure offer less value for money compared to PWLB.

Market loans offer forward fixing, which is not an option with PWLB, however as rates are forecast to remain relatively low over the next few years forward fixing brings marginal advantage.

- **Local Authority Bond Agency**

The UK Municipal Bonds Agency was established in June 2014 with the primary purpose of reducing local authority financing costs by:

- Issuing bonds in the capital markets and on-lending to councils.
- Lending between councils.
- Sourcing funding from 3rd party sources, and on-lending to councils.

The Agency's aim is to raise finance for Local Authorities by issuing municipal bonds to capital markets. The Agency has successfully issued a small number of bonds for local authorities, and the Council will continue to monitor the Agency's development and whether it can offer a competitive option for future borrowing.

9.11 These types of borrowing will need to be evaluated alongside their availability, particularly whilst there is a very limited availability of traditional market loans. The traditional market loans available tend to be Lender Option Borrower Option (LOBO) loans and they are not currently offered at competitive rates of interest. LOBOs provide the lender with future options to increase the interest rate whilst the local authority has the option to repay if the increase in the rate is unacceptable to them.

9.12 Following HRA reform the vast majority of the Council's existing debt portfolio consists of LOBOs and the Authority needs to consider diversifying its loan book to reduce the impact of any volatility that may cause these loans to be called. It should be noted that the Council’s current LOBO loans are unlikely to be called in the medium term at current interest rates.

***Sensitivity of the forecast***

9.13 In normal circumstances the main sensitivities are likely to be the two scenarios noted below. Council officers in conjunction with the treasury advisors will continually monitor the prevailing interest rates and the market forecast, adopting the following responses to a change of sentiment:

- ***If it were felt that there was a significant risk of a sharp FALL in long- and short-term rates****,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation then long-term borrowings will be postponed.

- ***If it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that current forecast****,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, the portfolio position will be re-appraised. The likely action will be that fixed rate funding will be drawn whilst interest rates remain relatively cheap.

***External v. Internal borrowing***

9.14 The current borrowing position reflects the historic strong Balance Sheet of the Council as highlighted in Section 6. The policy remains to keep cash as low as possible and minimise temporary investments.

9.15 The next financial year is again expected to be one of historically low albeit rising Bank Rate. This provides a continuation of the opportunity for local authorities to review their strategy of undertaking new external borrowing. At Appendix F there is an in-depth analysis of economic conditions provided by Link Asset Services, the Council’s independent treasury advisors.

9.16 Over the next three years, investment rates are expected to be significantly below long-term borrowing rates. This would indicate that value could best be obtained by limiting new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt.

9.17 This will be weighed against the potential for incurring additional long-term costs by delaying new external borrowing until later years when longer term rates are forecast to be marginally higher. Consideration will also be given to forward fixing rates whilst rates are favourable.

9.18 Against this background caution will be adopted within 2022/23 treasury operations. The Deputy Chief Executive and City Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision-making body at the next available opportunity.

***Policy on borrowing in advance of need***

9.19 From a statutory point of view a Local Authority has the power to invest for 'any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs.' The MHCLG takes an informal view that local authorities should not borrow purely to invest at a profit. This does not prevent the Council temporarily investing funds borrowed for the purpose of expenditure in the reasonable near future.

9.20 This Council will not borrow in advance of need to on-lend and profit from the difference in interest rate. Any decision to borrow in advance in support of strategic and service delivery objectives will be in the context of achieving the best overall value for money, for example to minimise the risk of borrowing costs increasing in the future and that the Council can ensure the security of such funds. In determining whether borrowing is undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt profile which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created and implications for future and budget have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
- consider the impact of borrowing in advance temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

***Forward Fixing***

9.21 As noted above, the Council will consider forward fixing debt, whereby the Council agrees to borrow at a point in the future at a rate based on current implied market interest rate forecasts. There is a risk that the interest rates proposed would be higher than current rates; however, it can be beneficial as it avoids the need to borrow in advance of need and suffer cost of carry. It can also play an important role in providing certainty of rates as part of the overall portfolio of debt. It may also represent a saving if rates were to rise in the future. Any decision to forward fix will be reviewed for value for money and will be reported to Members as part of the standard treasury management reporting.

***Debt Rescheduling***

9.22 It is likely that opportunities to reschedule debt in the 2022/23 financial year will be limited due to prevailing debt interest rates being relatively low.

9.23 As short-term borrowing rates will be considerably cheaper than longer term rates, there may be some opportunity to generate savings by switching from long term debt to short term debt. These savings will need to be considered in the light of the premiums incurred and the likely cost of refinancing those short-term loans once they mature, and the risk of sudden changes in the short term debt markets, compared to the current rates of longer-term debt in the existing portfolio.

9.24 The debt portfolio following HRA reform consists mainly of LOBOs, and the premia for rescheduling these make it unlikely there will be a cost-effective opportunity to reschedule. The premia relate to the future interest payments associated with the loan and compensation for the lender for the buy-back of the interest rate options the loan has embedded in it.

9.25 The Council will continue to monitor the LOBO market and opportunities to reschedule, redeem or alter the profile of existing LOBO debt. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the strategy outlined above in this section;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility)

9.26 Any restructuring of LOBOs will only be progressed if it provides value for money and reduces the overall treasury risk the Council faces. The Council’s Constitution delegates to the Deputy Chief Executive and City Treasurer the authority to pursue any restructuring, rescheduling or redemption opportunities available.

9.27 Consideration will also be given to the potential for making savings by running down investment balances to repay debt prematurely. It is likely short-term rates on investments will be lower than rates paid on current debt.

9.28 All rescheduling will be reported to the Executive as part of the normal treasury management activity. If rescheduling requires amendments to the Treasury Management Strategy the Deputy Chief Executive and City Treasurer will be asked to approve them in accordance with the delegated powers accorded to the position and the changes will be reported to Members.

## 10 Annual Investment Strategy

### *HRA*

10.1 In order to maintain efficient, effective and economic treasury management for the Council as a whole, the HRA will only be able to invest with the General Fund. This is discussed further in Appendix I.

### *General Fund*

### *Introduction*

10.2 The Council will have regard to the MHCLG's Guidance on Local Government Investments (the Guidance) and the 2011 and 2021 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council's investment priorities are:

- The security of capital; and
- The liquidity of its investments.

10.3 The risk appetite of the Council is low in order to give priority to the security of its investments. The Council will aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

10.4 The borrowing of monies by an Authority purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. However, the Council may provide loan finance funded from borrowing if this supports the achievement of the Council's strategies and service objectives.

10.5 The Council's TMSS focusses solely on treasury management investments. The Council does not hold any commercial investments and details of strategic capital investments can be found in the Capital Strategy and Budget Report to the Executive.

### *Investment Policy*

10.6 The Council's investment policy is to manage the Council's cash flow through investments in high credit quality.

10.7 As in previous years, the Council will not just utilise ratings as the sole determinant of the quality of an institution. It is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. The Council will engage with its advisors to maintain a monitor on market pricing such as 'credit default swaps'[1] and overlay that information on top of the credit ratings.

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[1] A credit default swap is a financial instrument that effectively provides the holder insurance against a loan

10.8 Investment in banks and building societies are now exposed to bail-in risk following the introduction of the EU's Banking Recovery and Resolution Directive, which means depositor's funds over £85,000 are at risk of "bail-in" if the bank fails. In response to this, the Council adopted lower operational limits for such investments in 2016/17 and these remain.

10.9 The exception is the limit with Barclays bank; Barclays is the Council's main banker and is the investment destination of last resort for the close of daily trading. These revised limits are operational changes and to preserve flexibility should circumstances change the overall investment limits approved for banks and building societies for 2021/22 will be maintained in 2022/23.

10.10 In line with the policy adopted in this strategy in previous years, options to diversify the investment portfolio have been reviewed and adopted. The Council now actively uses money market funds alongside deposits with banks, other local authorities and the Debt Management Agency.

10.11 For 2022/23 the Council will continue to consider investing in Treasury Bills, Certificates of Deposit and Covered Bonds. In addition to diversification each of these options offer the Council benefits which are noted in more detail below. These instruments require the Council to have specific custodian and broker facilities which have been opened. Officers are working to monitor these markets to prompt participation in the instruments when rates are favourable, and to identify and resolve any governance challenges arising from investing in instruments which have an active secondary market. Work is continuing to open further access points to markets and to identify opportunities for benefit which are new to the Council.

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

***Specified and Non-Specified Investments***

10.13 Investment instruments identified for use in the financial year are listed below and are all specified investments. Any proposals to use other non-specified investments will be reported to Members for approval.

10.14 Specified investments are sterling denominated, with maturities up to a maximum of one year and meet the minimum 'high' rating criteria where applicable. Further details about some of the specified investments below can be found in later paragraphs in this Section.

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defaulting. The CDS spread is the difference between the price at which providers are willing to sell the swap, and the price at which buyers are willing to buy. A relatively high spread may suggest that the loan is more likely to default.

| **Table 4** | **Minimum ‘High’ Credit Criteria** | **Use** |
|---|---|---|
| Term deposits – banks and building societies[2] | See Creditworthiness Policy. | In-house |
| Term deposits – other Local Authorities | High security. Only few local authorities’ credit-rated | In-house |
| Debt Management Agency Deposit Facility | UK Government backed | In-house |
| Certificates of deposit issued by banks and building societies covered by UK Government guarantees | UK Government explicit guarantee | In-house |
| Money Market Funds (MMFs) | AAA | In-house |
| Treasury Bills | UK Government backed | In-house |
| Covered Bonds | AAA | In-house |

***Creditworthiness Policy***

10.15 The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit rating from the three main credit rating agencies; Fitch, Moody’s and Standard & Poor’s. Link supplement the credit ratings of counterparties with the following overlays:

- Credit Watches and Credit Outlooks from credit rating agencies
- Credit Default Swap spreads to provide early warning of likely changes in credit ratings
- Sovereign Ratings to select counterparties from only the most creditworthy countries

10.16 The above are combined in a weighted scoring system which is then combined with an overlay of CDS spreads. The product is a series of colour coded bands which indicate the relative creditworthiness of counterparties.

[2] Banks & Building Societies

The Council will keep the investment balance below or at the maximum limit based on the institutions credit rating as detailed in paragraph 10.21-10.22. If this limit is breached, for example due to significant late receipts, the Deputy Chief Executive and City Treasurer will be notified as soon as possible after the breach, along with the reasons for it. Please note this relates to specific investments and not balances held within the Council’s bank accounts, including the general bank account.

10.17 The Council has regard to Link's approach to assessing creditworthiness when selecting counterparties as it uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue prominence to just one agency's ratings.

10.18 In summary the Council will approach assessment of creditworthiness by using the Link counterparty list and then applying its own counterparty limits and durations. All credit ratings will be monitored daily and re-assessed weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of Credit Ratings, the Council will be advised of information in Credit Default Swap against the iTraxx benchmark[3] and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

10.19 Sole reliance will not be placed on the use of this external service. In addition, the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

***Investment Limits***

10.20 In applying the creditworthiness policy, the Council holds the security of investments as the key consideration and will only seek to make treasury investments with counterparties of high credit quality.

10.21 The financial investment limits of financial institutions will be linked to their short and long-term ratings (Fitch or equivalent) as follows:

| Long Term | Amount |
|---|---|
| Fitch AA+ and above | £20 million |
| Fitch AA/AA- | £15 million |
| Fitch A+/A | £15 million |
| Fitch A- | £10 million |
| Fitch BBB+ | £10 million |

The Council will only utilise those institutions that have a short-term rating of F2 or higher, (Fitch or equivalent).

| | |
|---|---|
| UK Government (including the Debt Management Office) | £200 million |
| Greater Manchester Combined Authority | £200 million |
| Other Local Authorities | £20 million |

[3] The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Link Asset Services' Credit List.

10.22 In seeking to diversify the Council will utilise other investment types which are described in more detail below and ensure that the investment portfolio is mixed to help mitigate credit risk. The following limits will apply to each asset type:

| Total Deposit | Amount |
| --- | --- |
| Local Authorities | £250 million |
| UK Government | £200 million |
| - Debt Management Office | |
| - Treasury Bills | |
| Money Market Funds | £75 million |
| Certificates of Deposit | £25 million |
| Covered Bonds | £25 million |

10.23 It may be prudent to temporarily increase the limits shown above, as in the current economic environment it is increasingly difficult for officers to place funds. If this is the case officers will seek approval from the Deputy Chief Executive and City Treasurer and any increase in the limits will be reported to Members through the normal treasury management reporting process.

10.24 This has been the approach taken over the last 12 months as a number of investment instruments available to the Council have offered negative interest rates, which would diminish the principal invested. In those circumstances officers have reviewed alternative investment instruments, and have requested temporary increases to investment limits, balancing the risks of doing so with the desire to avoid losing capital value.

***Durational Limits***

10.25 Operationally the Council has in recent years not invested cash for more than three months, which was a product of security concerns following the financial crisis of 2008/09 and the relatively volatile nature of the Council's cash flow.

10.26 The financial markets have changed significantly since 2008/09, and the transparency of creditworthiness has improved. It is therefore proposed that the Council formally states, as part of the Investment Strategy, that it will invest for up to 364 days provided that such investments form part of the management of the cash flow and not for increased yield. On this basis, such investments will only be made if the cash flow forecast at the time indicates a level of "core" cash which will not be required for the investment period.

10.27 Should negative interest rates become prevalent, the average length of investments held may need to be reviewed and increased to protect the capital value of the sums invested. However, as noted above, reviewing investment limits would also be considered.

### *Environmental, Social and Governance Investment Policy*

10.28 The investment classes detailed in this Strategy are almost exclusively short term in nature, and therefore establishing investment criteria for environmental, social and governance (ESG) factors is challenging.

10.29 There are several approaches to ESG investing, but they all focus on investments which will have a positive return and a long term impact in people, the environment, and how business is conducted. This is particularly important when the investment takes the form of equity, and therefore the investor can use their influence in corporate matters.

10.30 None of the investment classes contained within this Strategy provide that level of influence. Instead, the treasury management team will continue to screen potential investments to make sure that institutions demonstrate a significant level of commitment to ESG matters, are aligned to the Council's corporate objectives and approaches, and will not invest if there are concerns.

### *Money Market Funds*

10.31 The removal of the implied levels of sovereign support that were built into ratings throughout the financial crisis has impacted on bank and building society ratings across the world. Rating downgrades can limit the number of counterparties available and to provide flexibility the Council will use MMFs when appropriate as an alternative specified investment.

10.32 MMFs are investment instruments that invest in a variety of institutions therefore diversifying the investment risk. The funds are managed by a fund manager and have objectives to preserve capital, provide daily liquidity and a competitive yield. Most money market funds invest both inside and outside the UK. MMFs also provide flexibility as investments and withdrawals can be made daily.

10.33 MMFs are rated through a separate process to bank deposits. This looks at the average maturity of the underlying investments in the Fund as well as the credit quality of those investments. The Council will only use MMFs where the institutions hold the highest AAA credit rating and those which are UK or European based.

10.34 As with all investments there is some risk with MMFs in terms of the capital value of the investment. European legislation has required existing and new Constant Net Asset Value MMFs to convert to a Low Volatility Net Asset Value (LVNAV) basis by January 2019. This basis allows movements in capital value, but there is a restriction that the deviation cannot be more than 20 basis points, e.g. on a deposit of £100 the Fund must ensure withdrawal proceeds are no greater than +/- 20p.

***Treasury Bills***

10.35 Treasury Bills are marketable securities issued by the UK Government and counterparty and liquidity risk is relatively low although there is potential risk to value arising from an adverse movement in interest rates unless they are held to maturity.

***Certificates of Deposit***

10.36 Certificates of Deposit are short dated marketable securities issued by financial institutions, so the counterparty risk is low. The instruments have flexible maturity dates, so it is possible to trade them in early although there is a potential risk to capital if they are traded ahead of maturity and there is an adverse movement in interest rates. Certificates of Deposit are subject to bail-in risk as they are given the same priority as fixed deposits if a bank was to default. The Council will only deal with Certificates of Deposit that are issued by banks and meet the credit criteria.

***Covered Bonds***

10.37 Covered Bonds are debt instruments secured by assets such as mortgage loans. They are issued by banks and other non-financial institutions. The loans remain on the issuing institutions' Balance Sheet and investors have a preferential claim in the event of the issuing institution defaulting. All issuing institutions are required to hold enough assets to cover the claims of all covered bondholders. The Council would only deal with bonds that are issued by banks which meet the credit criteria, or AAA rated institutions, (e.g. insurance companies).

***Liquidity***

10.38 Based on cash flow forecasts, the level of cash balances in 2022/23 is estimated to range between £0m and £300m. The higher level can arise where for instance large Government grants are received or long-term borrowing has recently been undertaken.

***Investment Strategy to be followed in-house***

10.39 Link's view of the forecast Bank Rate is noted at Section 9. Link's view is that the Bank Rate will increase during 2022, given the high inflation outlook.

10.40 There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

10.41 The Council will avoid locking into longer term deals while investment rates are at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the Council.

10.42 For 2022/23 it is suggested the Council should target an investment return of 0% to 0.20% on investments placed during the financial year, reflecting the ongoing significant market uncertainty. For cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to six months) in order to benefit from the compounding of interest.

10.43 The Bank of England and the Financial Conduct Authority (FCA) are committed to phasing out LIBOR. To date the Council has used LIBOR as a benchmark rate for investments and temporary borrowing. The Bank of England formed the Risk-Free Rate Working Group which recommended a reformed Sterling Overnight Index Average (SONIA) as the alternative unsecured risk - free rate for the Pound Sterling (GBP) LIBOR Market. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other investors. Treasury Management will therefore adopt the use of SONIA as a benchmark rate moving forward.

10.44 The SONIA rate will also be applied to any transfer rates between the General Fund and the HRA, further details are outlined in Appendix I. Treasury Management will apply mitigating changes to the transfer rates if the benchmark rates were to go into negative territory.

***End of year Investment Report***

10.45 At the end of the financial year, the Council will receive a report on investment activity as part of the Annual Treasury Management Report.

***Policy on the use of External Service Providers***

10.46 The Council uses Link Asset Services as external treasury management advisors and has access to another provider who is an approved supplier should a second opinion or additional work be required. The Council recognises that responsibility for treasury management decisions always remains with the organisation and will ensure that undue reliance is not placed upon its external service providers.

10.47 The Council recognises there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. It will ensure the terms of the Advisor’s appointment and the methods by which their value is assessed are properly agreed and documented and subjected to regular review.

## 11 Scheme of Delegation

11.1 Appendix D describes the responsibilities of Member groups and officers in relation to treasury management.

## 12 Role of the Section 151 Officer

12.1 Appendix E notes the definition of the role of the Deputy Chief Executive and City Treasurer in relation to treasury management.

## 13 Minimum Revenue Provision (MRP) Strategy

13.1 Appendix B contains the Council's policy for spreading capital expenditure charges to revenue through the annual MRP charge.

## 14 Recommendations

14.1 Please see the start of the report for the list of recommendations.

## 15 Contributing to a Zero-Carbon City

15.1 Treasury Management activity underpins the Council's finances, and therefore supports projects and initiatives which seek to achieve the Council's zero carbon target.

## 16 Contributing to the Our Manchester Strategy

16.1 The Treasury Management function supports the whole Council by seeking to ensure that funding is available when required, to fund all the work that the Council undertakes. Therefore, whilst not directly contributing to the strategic aims, the Council's treasury management activity underpins the work taking place elsewhere to achieve the outcomes.

## 17 Key Policies and Considerations

### (a) Equal Opportunities

17.1 None.

### (b) Risk Management

17.2 CIPFA's Prudential and Treasury Management Codes provide the risk management framework within which the treasury management activities of the Council operate. The Strategy should be the Council's approach to this framework.

### (c) Legal Considerations

17.3 None.