Manchester City Council
Report for Information

Report to: Audit Committee – 29 November 2022

Subject: Treasury Management Interim Report 2022-23

Report of: Deputy Chief Executive and City Treasurer

Purpose

To report the Treasury Management activities of the Council during the first six months of 2022-23.

Recommendations

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

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Wards Affected: Not Applicable

Contact Officers:

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

Name: Tom Wilkinson
Position: Deputy City Treasurer
Telephone: 0161 234 1445
E-mail: tom.wilkinson@manchester.gov.uk

Name: Tim Seagrave
Position: Commercial Finance Lead
Telephone: 0161 234 3445
E-mail: timothy.seagrave@manchester.gov.uk

Name: Charlotte Arrowsmith Jones
Position: Senior Finance Manager
Telephone: 0161 277 1887
E-mail: charlotte.arrowsmithjones@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 2022/23, including Borrowing Limits and Annual Investment Strategy (Executive – 16th February 2022, Resource and Governance Scrutiny Committee – 28th February 2022, Council – 4th March 2022)

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 Code). The City Council has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Chief Financial Officer Responsibilities, and delegation and reporting arrangements.

1.2 CIPFA amended the CIPFA Treasury Management in the Public Services Code of Practice in late 2011, 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, and has been approved as part of each the annual TMSS ever since. This report therefore ensures that the Council meets the requirements of the Strategy, and therefore the Code.

1.3 The Code was revised in 2021 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: Portfolio Position as at 30th September 2022
Section 3: Review of Economic Conditions 2022-23 to date
Section 4: Treasury Borrowing in 2022-23 to date
Section 5: Compliance with Prudential Indicators and Treasury Limits
Section 6: Investment Strategy for 2022-23 to date
Section 7: Temporary Borrowing and Investment for 2022-23 to date
Section 8: Implications of Rising Interest Rates
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 2022

2.1 As outlined in the approved TMSS for 2022/23 it was anticipated that there would be a need to undertake some permanent borrowing in 2022/23 to fund the capital programme and to replace some of the internally borrowed funds.

2.2 The six months since the start of April have been characterised by a volatile financial market, with bank rate rises to tackle growing inflation, and long-term interest rates also becoming significantly more expensive. In this environment the Council has sought to take additional borrowing in line with the needs of the cash flow.

2.3 Further borrowing is likely to be required during the second half of the year. The Council's debt position at the beginning of the financial year and at the end of September is compared in the table below. The gross debt is significantly below both the Council's capital financing requirement, and the authorised limit shown in appendix B.

Loan Type	**31 March 2022**				**30 September 2022**			
	GF	HRA	Principal	Avg. Rate	GF	HRA	Principal	Avg. Rate
	£m	£m	£m	%	£m	£m	£m	%
PWLB	400.0	0.0	400.0	2.00	500.0	0.0	500.0	2.32
Temporary Borrowing	10.7	0.0	10.7	0.34	62.1	0.0	62.1	2.67
Market Loans	334.2	61.4	395.7	4.47	334.2	61.4	395.7	4.47
Stock	0.9	0.0	0.9	4.00	0.9	0.0	0.9	4.00
Government Lending	19.4	0.0	19.4	0.00	17.3	0.0	17.3	0.00
Gross Total	**765.2**	**61.4**	**826.7**	**3.11**	**914.5**	**61.4**	**976.0**	**3.17**
Temporary Deposits	(122.7)	0.0	(122.7)	0.47	(180.2)	0.0	(180.2)	1.88
Internal Balances (GF/HRA)	49.5	(49.5)	0.0	0.00	*49.3*	*(49.3)*	*0.0*	*0.00*
Net Total	**692.0**	**11.9**	**703.9**	**-**	***652.5***	***17.1***	***669.6***	***-***

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

2.5 As detailed in section 4 below, the Council has borrowed £150m during the period. The debt has been split between medium term PWLB debt and short term (364 day) borrowing from other local authorities.

2.6 Total Government Debt dropped from £19.4m to £17.3m due to a scheduled repayment of £2.1m of Salix loans. A further £1.4m was also temporarily borrowed from local partner organisations.

2.7 Total debt has therefore increased by £149.3m during the first six months of 2021/22.

2.8 The cash flow forecast suggests the level of deposits will continue to fall resulting in further borrowing being required prior to year-end. Markets and independent forecasts are being monitored on a daily basis by the Treasury team to optimise the interest rates borrowed at and the blend of short term and long-term borrowing that is appropriate given the market conditions and outlook. Any such activity will be reported in the outturn report.

3 Review of Economic Conditions 2022-23 to date

3.1 The Bank of England had a lending rate at 0.75% at the start of the financial year. There have been 4 subsequent rate changes with lending rates at 2.25% by 30 September. The Monetary Policy Committee (MPC) is expected to increase interest rates further from 2.25% currently to a peak of 5.00% in February 2023.

3.2 Appendix C provides a more detailed review of the economic situation, provided by the Council's treasury management advisors.

4 Treasury Borrowing in 2022-23 to date

PWLB

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 Standard Borrowing Rates 2022-23 to date for 1 to 50 years					
	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	2.15%	2.38%	2.56%	2.72%	2.45%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.31%	5.64%	5.55%	6.00%	5.71%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	3.01%	3.12%	3.33%	3.64%	3.37%

4.2 The spread shown between the highs and lows for loans of each period in the table above highlight the challenges of the current market environment. It illustrates the general increase in rate over the period, with the lowest rates across all durations occurring in the first weeks of 2022/23 and the higher rates all at the end of the period. Rates have subsequently fallen back a little.

4.3 Manchester continues to be 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 in the previous table.

4.4 The Council borrowed £100m from the PWLB during the first half of the year, as detailed in the table below, at an average rate of c 3.65%. This was based on cash flow need, and ultimately is to fund the Council's capital programme.

Maturity Date	Value (£m)	Interest Rate (%)
09/03/2028	30	3.66
09/09/2028	35	3.65
09/09/2029	35	3.64
Total	100	3.65

4.5 The loan values and maturity dates are aligned to expected future annual minimum revenue provision (MRP) charges that the Council can use to fund the repayments. The medium-term maturities reflected the increasing interest rate environment and the market expectation that rates would fall back in future years, and therefore a desire not to enter into long term debt at what would be comparatively high rates.

Temporary Borrowing

4.6 Temporary borrowing of £50m was taken from other local authorities. As with the PWLB debt it was based on cash flow need and is to fund the capital programme, with the length of the loans at under a year being a further mitigation against rates falling, as currently forecast, once inflation reaches the expected peak early next year.

Salix Borrowing

4.7 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 supported scheme in relation to LED lighting Council projects will be repaid by 1st April 2023.

4.8 In the first half of the year, the Council repaid £2.1m in line with the agreed repayment schedule, bringing the total value of Salix debt to £8.9m on 30th of September 2022.

5 Compliance with Prudential Indicators and Treasury Limits

5.1 The Council sets an operational limit on the cleared balance that is left within the Council's current accounts. The limit is aimed at minimising the cash held in these accounts which attracts no interest and thereby maximises the investment return for the authority. The limit is set at £400k and this was met during the first half of the financial year except for the breaches described below.

5.2 Where the limit is breached it means that the Council either incurred interest costs due to being in an overdraft position 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.

5.3 During the period 1st April to 30th September 2022 there were six breaches of the daily £0-400k limit on the Barclays current account.

i. On these six occasions, the limit was breached due to various late afternoon receipts which the Treasury Management team had not been made aware of. Where possible, officers are asked to inform the team of any expected receipts or payments over £50k in order to efficiently manage cash.

5.4 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, which in the current interest market is minimal.

6 Investment Strategy for 2022-23 to date

6.1 The Treasury Management Strategy Statement (TMSS) for 2022-23 was approved by Executive on 16th February 2022. 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 During the financial year the Council's temporary cash balances have been managed by the Deputy Chief Executive and City Treasurer in-house and invested with those institutions listed in the Council's Approved Lending List. Officers can confirm these institutions meet the security criteria set out in the Annual Investment Strategy agreed at Executive in February and Council in March.

7 Temporary Borrowing and Investment for 2022-23 to date

7.1 Liquidity has remained a key focus for the treasury management function, alongside agreeing additional debt as noted above.

7.2 As interest rates have risen, investment rates have increased although there has been a lag following the Bank of England rate rises on some investment instruments. The average level of funds available for investment purposes in the first six months of 2022/23 was £130.3m. 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.

7.3 As noted, additional temporary borrowing was taken during the first half of the year. The average level of temporary borrowing in this period was £18.5m.

7.4 Detailed on the next table is the temporary investment and borrowing undertaken by the Council. Historically this has been compared to the average equivalent London Inter-Bank investment or borrowing rate (LIBOR/LIBID), but following changes implemented to the UK financial markets these rates are no longer calculated. The benchmark rate is now the Sterling Overnight Index

Average (SONIA), being the overnight rate of interest banks pay to borrow sterling overnight, unsecured, from other financial institutions. With SONIA there is no “spread”, being the difference between the rate a financial institution would offer to borrow funds and the rate it would accept for funds it wished to invest.

7.5 This change means that the benchmark rate is now based on observable data, whereas LIBOR/ID was based on information provided by major banks. The impact on SONIA of changes in the Bank of England bank rate is far more immediate, particularly when compared to the investment instruments that the Council uses where there is a time lag between bank rate changing and the rate offered for the instrument reflecting that change. As interest rates have risen during the first six months of the 22/23 financial year it has therefore taken some time for the Council’s investments to rise to similar levels.

7.6 As illustrated, the Council underperformed the benchmark by 10 basis points on investments. To some extent this is as expected, as SONIA does not reflect the spread between borrowing and investing, and the latter would be expected to be lower. The treasury team will continue to search for stronger inter-Local Authority market rates and Money Market Funds which could improve return without compromising security of the funds.

7.7 The temporary borrowing portfolio consisted of loans with various investment tenors ranging from 14-day notice terms to fixed one-year maturities. The latter reflected the increases in interest rates over the period as they were taken in September and formed roughly 5/6 of the temporary borrowing at the end of the month. The average cost was therefore higher by 30 basis points when compared to the SONIA benchmark, but for context SONIA as at the 30 September was 2.19%, significantly higher than the average rate achieved.

	Average temporary investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£130.3m	1.12%	1.22%
Temporary Borrowing	£18.5m	1.52%	1.22%

**Average SONIA 1st April -30th September 22*

7.7 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 Implications of Rising Interest Rates

8.1 Since the end of the 2021 calendar year interest rates have risen significantly, having been at historic lows for over a decade since the financial crisis in 2008. Whilst this is a challenging environment in which the Council must make debt and investment decisions given the volatility, the change in market rates also brings risks and opportunities which did not exist when rates were low and benign.

8.2 One such opportunity is the forward fixing of debt. As noted in the Treasury Management Strategy Statement, some financial institutions are willing to agree to lend at a fixed future point in time but fix the rate now. This would provide the Council with rate certainty for future debt, at a time when rates have been rising. However, it is not without risk, as rates could fall between the time the loan is agreed and when it is due to start, making the loan appear expensive compared to prevailing rates on the start date. However, critically, the Council would have had certainty over the rate.

8.3 Officers will continue to discuss potential debt opportunities with market participants, including over forward fixing of loans, but will only progress if any arrangements can provide value for money over the long term, and the risks of entering any arrangements are acceptable.

8.4 There is also an emerging risk regarding lender option borrower option (LOBO) loans that the Council holds. LOBO loans have options on specific dates that allow the lender to change the interest rate (the lender option), and the borrower can choose to repay the loan if the new rate is unacceptable (the borrower option). The loans have interest rates above 4%, and therefore over the last decade no lender has sought to exercise their option. However, with rates rising there is a risk that the lenders could seek to do so.

8.5 Officers will monitor the market and market expectations for interest rates, alongside any intelligence from the Council’s treasury management advisors, to monitor this risk. Should any options be exercised by any of the lenders, the decision to agree to a revised rate or repay will also be based on achieving value for money over the long term.

9 Conclusion

9.1 The first six months of year 2022/23 have seen significant levels of market volatility, and interest rate increases. The Council has taken additional debt in the period to fund the capital programme but has done so in a way which seeks to limit the long-term impact of higher interest rates, given market expectations that rates will fall back. There is a further borrowing requirement expected in the latter half of the year.

9.2 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.

9.3 Proactive treasury management during the year has sought to minimise borrowing costs for the Council and maximise returns on investments. Officers will continue to evaluate financial markets to look for opportunities and risks within the context of the agreed treasury management strategy