Manchester City Council
Report for Information

Report To: Audit Committee – 25 July 2023

Subject: Treasury Management Outturn Report 2022-23

Report of: Deputy Chief Executive and City Treasurer

Purpose

To report the Treasury Management activities of the Council during the financial year 2022-23.

Recommendations

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

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Wards Affected:

Not Applicable

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Background documents (available for public inspection):

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. The revised Code recommended local authorities include, as part of their Treasury Management Strategy Statement, the requirement to report to members at least twice a year on the activities of the Treasury Management function. This report, along with the Interim Treasury Management report received by the Audit Committee on the 29th November 2022 therefore ensures that the Council meets the requirements of the Strategy, and therefore the Code.

1.3 Treasury Management in this context is defined as:
'*The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks*'.

1.4 This outturn report covers:

Section 1: Introduction and Background
Section 2: Portfolio Position as at 31st March 2023
Section 3: Review of Economic Conditions 2022-23
Section 4: Treasury Borrowing in 2022-23
Section 5: Compliance with Prudential Indicators and Treasury Limits
Section 6: Investment Strategy for 2022-22
Section 7: Temporary Borrowing and Investment for 2022-23
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 31st March 2023

2.1 As outlined in the approved Treasury Management Strategy Statement (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 Council has faced a challenging market environment, with volatile financial markets, numerous bank rate rises to tackle growing inflation, and long term interest rates also becoming significantly more expensive.

2.3 During the year, the temporary borrowing taken during 2021/22 matured and has been refinanced with long term debt from the Public Works Loan Board (PWLB). The Council's debt position at the beginning and the end of the financial year shown in the table below. The gross debt is significantly below both the Council's capital financing requirement, which is its underlying need to borrow, and the authorised limit (the maximum amount it is allowed to borrow) shown in appendix B.

2.4

Loan Type	31 March 2022				31 March 2023			
	GF £m	HRA £m	Principal £m	Avg. Rate %	GF £m	HRA £m	Principal £m	Avg. Rate %
PWLB	400.0	0.0	400.0	2.00	500.0	0.0	500.0	2.23
Temporary Borrowing	10.7	0.0	10.7	0.34	130.2	0.0	130.2	2.64
Market Loans	334.2	61.4	395.7	4.47	330.9	60.7	390.7	4.13
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	15.3	0.0	15.3	0.00
Gross Total	**765.2**	**61.4**	**826.7**	**3.11**	**976.3**	**60.7**	**1037.0**	**2.96**
Temporary Deposits	(122.7)	0.0	(122.7)	0.47	(77.3)	0.0	(77.3)	1.58
Internal Balances (GF/HRA)	49.5	(49.5)	0.0	0.00	63.2	(63.2)	0.0	0.00
Net Total	**692.0**	**11.9**	**703.9**	**-**	**962.2**	**(2.5)**	**959.7**	**-**

2.5 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.

2.6 As detailed in section 4 below, throughout the financial year 2022/23 the Council has borrowed £220.0m. The debt has been split between £100m of medium term PWLB debt and £120m of short term (364 day) borrowing from other local authorities. Market debt of £5.0m also matured during the year and was repaid.

2.7 Total Government borrowing dropped from £19.4m to £15.3m due to the planned repayment of £4.1m SALIX loans.

2.8 Total gross debt has therefore increased by £211.3m throughout the financial year 2022/23.

3 Review of Economic Conditions 2022-23

3.1 The financial year provided challenging market conditions, with Bank Rate rising throughout the year, which along with inflation concerns pushed gilt yields higher, significantly increasing the cost of debt for the Council. The Bank of England had a lending rate at 0.75% at the start of the financial year, and there were 8 subsequent rate increases to 4.25% by 31 March, a level not seen since early October 2008 – it has subsequently risen to 5.00% by June 2023.

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

4 Treasury Borrowing in 2022-23

4.1 The borrowing strategy for the year, as approved as part of the budget, was to borrow medium term debt with maturities to match the estimated Minimum Revenue Provision, the annual provision the Council is required to make to reduce debt, that is generated in the same period.

4.2 As interest rates began to rise during the year, interest rate forecasts suggested that rates would peak as inflation peaked, and would then fall back within the next 18-24 months, although they would be unlikely to reach the historic lows seen previously. The borrowing approach for the Council was therefore to agree medium term debt if rates were affordable, but otherwise take temporary funding that could be re-financed at a point where rates were expected to be lower.

4.3 The debt taken during the year is described in more detail below.

PWLB

4.4 PWLB interest rates during the year are illustrated in the table below, which sets out the low points and high points during the year for key maturity periods. This is also illustrated in the graph at Appendix A, which highlights how volatile rates have been. All maturity periods saw an increase in rates towards the end of the financial year.

PWLB Standard Borrowing Rates 2022-23 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%	5.65%	6.08%	5.71%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022

Average	3.77%	3.82%	3.96%	4.27%	3.94%

4.5 The Council borrowed £100m from the PWLB in September 2022, 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

4.6 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

4.7 Temporary borrowing of £120m was taken from other local authorities, £50m in September 2022 £40m in January 2023, and £30m in March 2023. As with the PWLB debt it was based on cash flow need and is to fund the capital programme, with relatively short maturity rates on the expectation that interest rates would begin to fall.

Salix Borrowing

4.8 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.

4.9 During the year, the Council made scheduled repayments of £4.1m, bringing the total value of Salix debt to £6.7m on 31st March 2023.

4.10 The borrowing strategy will remain under constant review to support achieving value for money for the Council whilst balancing the treasury risks that any approach will create.

5 Compliance with Prudential Indicators and Treasury Limits

5.1 The Council operated within the updated prudential indicators, and performance against these is shown in Appendix B.

5.2 The Council also 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 financial year with the exception of the breaches described below.

5.3 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.

5.4 During the period 1st April to 31th March 2023 there were eight breaches of the daily £0-400k limit on the Barclays current account. On each occasion 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.

5.5 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 investing the surplus cash, which in the current interest market is minimal.

6 Investment Strategy for 2022-23

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 The Strategy details the investment limits the Council has for counterparties, based on an assessment of their creditworthiness, to a maximum of £20m for any single organisation other than the UK Government or the Greater Manchester Combined Authority. It also provides information on the types of investment instruments that the Council will use, including bank deposits, deposits with other local authorities and the UK Government, and money market funds (MMFs).

6.3 The Council continues to operate a total of five MMFs with an upper limit of £15.0m per fund. The Council also holds ongoing contingency call accounts with two major banks to help maintain liquidity.

6.4 The current strategy means that a significant proportion of the Council's investments are with the chosen five MMFs, the Debt Management Office (DMO), and other Local Authorities. This highlights the relatively low rate of credit risk that the Council takes when investing.

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

6.6 During the financial year 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

7.1 Liquidity has remained a key focus for the treasury management function, alongside the agreeing additional debt as highlighted 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 2022/23 was £116.2m. 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 in 22/23 to help mitigate interest rate risk. The average level of temporary borrowing in this period was £48.7m, but was £130.2m by year end.

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.

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 throughout 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 82 basis points on investments. This is predominantly because the Council has less money to invest towards the end of the year, when rates rose, compared to the start of the year when they were relatively low, which is a product of the over-arching treasury management approach of running down cash balances before taking new debt. 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 two-year maturities. As noted in the table below, the average cost was equivalent to the overnight benchmark, but the length of the debt was significantly longer than overnight which would ordinarily be expected to incur a higher rate.

	Average temporary investment /borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£116.2m	1.90%	2.72%
Temporary Borrowing	£48.7m	2.72%	2.72%

* *Average SONIA 1st April -31st March 23*

7.8 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 As noted above, the Bank of England base rate has continued to rise in the early part of the 2023/24 financial year which, along with persistent inflation concerns, has seen interest rates continue to rise, with an expectation that they will reduce over the next 2 to 3 years. This means that any debt taken by the Council will be at rates significantly higher than those for the debt taken in 2022/23, and there is a benefit in keeping maturities relatively short so that the Council can benefit as rates fall.

8.2 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.

8.3 As noted in the Treasury Management Strategy Statement and the Interim Report, 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.

8.4 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.

8.5 There is also a continuing 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.

8.6 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 2022/23 financial year has seen interest rates continue to move away from previous historic lows, as central banks across the world look to combat significant inflation pressure. In this challenging market environment the Council has taken a hybrid approach to borrowing, taking some medium term debt to provide cost certainty, and some shorter debt in the expectation that it will need to be refinanced when rates have fallen back.

9.2 Overall, 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 It is important to note that this strong balance sheet position is not without risk, and with interest rates rising the timing and structure of future debt financing will be important in sustaining this position.

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