Manchester City Council
Report for Information

Report to: Audit Committee – 28 November 2023

Subject: Treasury Management Interim Report 2023-24

Report of: Deputy Chief Executive and City Treasurer

Summary

To report the Treasury Management activities of the Council during the first six months of 2023-24.

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 2023-24, including Borrowing Limits and Annual Investment Strategy (Executive – 15th February 2023, Resource and Governance Scrutiny Committee – 27th February 2023, Council – 3rd March 2023)

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:

2 Portfolio Position as at 30th September 2023

2.1 The approved TMSS for 2023/24 anticipated that there would be a need to undertake some permanent borrowing in 2023/24 to fund the capital programme and to replace some of the internally borrowed funds. This need for replacement reflects the use of reserves within the revenue and capital budgets. As expected, the Council has needed to borrow in the six months to the end of September 2023.

2.2 The six months since the start of April have been characterised by a challenging financial market landscape, with growing and persistent inflation causing the Bank of England to increase bank rate significantly, 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 Throughout the period long term interest rate forecasts have suggested that rates will peak with inflation and then begin to fall back, and therefore long-term borrowing has not been attractive. When borrowing, the strategy has therefore been to borrow across a range of relatively short-term maturities, for example less than 5 years, so that the debt can be refinanced at a point in time where rates are expected to be significantly lower. Under this strategy maturities are spread given the timing of any fall in rates is unknown, so it mitigates the exposure to higher rates for a sustained period.

2.4 Further borrowing is expected to be required during the second half of the year. The Council's debt position at the end of the last 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 2023**				**30 Sept 2023**			
	GF £m	HRA £m	Principal £m	Avg. Rate %	GF £m	HRA £m	Principal £m	Avg. Rate %
PWLB	500.0	0.0	500.0	2.23	620.0	0.0	620.0	2.53
Temporary Borrowing	130.2	0.0	130.2	2.64	137.6	0.0	137.6	4.93
Market Loans	330.9	60.7	390.7	4.13	330.0	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	15.3	0.0	15.3	0.00	13.2	0.0	13.2	0.00
Gross Total	**976.3**	**60.7**	**1037.0**	**2.96**	**1101.7**	**60.7**	**1162.4**	**3.32**
Temporary Deposits	(77.3)	0.0	(77.3)	1.58	(120.9)	0.0	(120.9)	4.43
Internal Balances (GF/HRA)	63.2	(63.2)	0.0	0.00	65.5	(65.5)	0.0	0.00
Net Total	**962.2**	**(2.5)**	**959.7**	**-**	**1046.3**	**(4.8)**	**1041.5**	**-**

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.

2.5 The table above highlights that the Council has increased borrowing by c. £125.4m during the period. The debt has been split between £120.0m medium term PWLB debt and £95.0m short term (364 day) borrowing from other local authorities, with £87.4m of temporary borrowing including local authority debt being repaid. During the first half of the year various shorter term temporary deals were agreed and repaid, and loans that matured were replaced in line with cash flow need.

2.6 Further, total Government Debt dropped from £6.8m to £4.7m due to a scheduled repayment of £2.0m of Salix loans.

2.7 The cash flow forecast suggests the level of deposits currently held will continue to fall resulting in further borrowing being required prior to year-end. Markets and independent forecasts are being monitored daily 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 2023-24 to date

3.1 The Bank of England base rate was 4.25% at the start of the financial year. There have been 3 subsequent rate changes with lending rates at 5.25% on 30 September. The Monetary Policy Committee (MPC) voted by a majority to maintain Bank Rate at 5.25% in September and November with the next review of Bank Rate on 14 December 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 2023-24 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 2023-24 to date for 1 to 50 years

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.85%	4.34%	4.40%	4.78%	4.47%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	06/04/2023
High	6.56%	6.13%	5.71%	5.93%	5.63%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	22/08/2023
Average	5.82%	5.36%	5.21%	5.48%	5.20%

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. 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 £120m from the PWLB during the first half of the year, as detailed in the table below, at an average rate of c 5.65%. This was based on cash flow need, and ultimately is to fund the Council's capital programme.

Maturity Date	Value (£m)	Interest Rate (%)
28/02/2026	40	5.75
30/01/2027	80	5.6
Total	120	5.65

4.5 The short-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 As at 30th September the level of Temporary Borrowing taken in the year from other local authorities is £95m. This includes replacing some temporary borrowing that matured in the first half of the financial year (£80.0m). 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 by the middle of 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 2025.

4.8 In the first half of the year, the Council repaid £2.0m in line with the agreed repayment schedule, bringing the total value of Salix debt to £4.7m on 30th of September 2023.

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 first half of 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 30th September 2023 there were five breaches of the daily £0-400k limit on the Barclays current account. All breaches were above the £400k limit, and therefore meant a loss of potential income.

5.5 On these five occasions, the limit was breached due to various late afternoon receipts which the Treasury Management team had not been expecting on that day. Where possible, officers are asked to inform the team of any expected receipts or payments over £50k in order to efficiently manage cash however, due to the nature and unpredictability of some receipts this is not always possible. For example, where the receipt relates to a property transaction the timing of it is dependent on legal agreements being signed on both sides, and then the funds being released, and therefore officers cannot always be sure when that will take place.

5.6 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 2023-24 to date

6.1 The Treasury Management Strategy Statement (TMSS) for 2023-24 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 2023-24 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 2023/24 was £105.0m. 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 £129.4m.

7.4 Detailed in the next table is the temporary investment and borrowing undertaken by the Council. The benchmark rate is 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 The benchmark rate is based on observable data. The impact on SONIA of changes in the Bank of England bank rate is relatively 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 23/24 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 18 basis points on investments. This reflects the time lag noted above, as increases in rates take time to flow through to the instruments that the Council uses to invest. The treasury team will continue to search for inter-Local Authority market rates and Money Market Funds which could improve return without compromising security of the funds.

7.6 The temporary borrowing portfolio consisted of loans with various investment tenors ranging from notice terms to fixed two-year maturities. As noted in the table below, the average cost was lower by 96 basis points when compared to the 12 month benchmark.

	Average Temporary Investment /Borrowing	Net Return/Cost	Benchmark Return / Cost *

Temporary Investments	£105.0m	4.85%	5.03%
Temporary Borrowing	£129.4m	4.07%	5.03%

** Average SONIA 1st April -30th September 23*

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 OFLOG and DLUHC statistics

8.1 In July the Office for Local Government (OFLOG) launched the Local Authority Data Explorer. This is an online tool which brings together a selection of existing metrics, aimed at providing data and analysis of the performance of local government.

8.2 Within the metrics there are two that relate to the impact of capital expenditure, specifically debt servicing costs as a percentage of core spending power, and total debt as a percentage of core spending power. The intention of these metrics is to compare an authority's debt and debt financing costs to its ability to repay them.

8.3 In both cases, the published metrics show Manchester as being slightly higher than the median for similar authorities, which is expected given the size of the authority. It is important to note that the Council proactively manages the debt position and monitors prevailing market conditions to ensure that risks are mitigated as far as possible, for example through establishing the capital financing reserve to support the revenue budget if interest rates are higher than forecast.

8.4 Further, the Department of Levelling Up, Homes and Communities (DLUHC) have consulted on the statistics intended to be used for the four metrics included in the Levelling Up bill, which are aimed at identifying capital risk at an authority level DLUHC.

8.5 The outcome of the consultation, and the final statistics, will be reported to members once they are published.

8.6 The Council is also awaiting the outcomes of the recent DLUHC consultation on Minimum Revenue Provision (MRP). It is unlikely that changes will be required to the existing MRP policy, as the current policy aligns closely with the existing regulations.

9 Implications of Rising Interest Rates

9.1 As noted above, the Bank of England base rate 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 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.

9.2 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.

9.3 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. Critically, the Council would have had certainty over the rate.

9.4 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.

9.5 There is also a continuing 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, there is a risk that should rates continue to rise, that lenders could seek to do so.

9.6 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.

10 Conclusion

10.1 The first six months of year 2023/24 have seen a challenging financing market with increasing interest rates. The Council has taken additional debt in the period to fund the capital programme but has sought loans of short to medium term length to limit the long-term impact of higher interest rates, given market expectations that rates will fall back. There is an anticipated further borrowing requirement in the latter half of the year.

10.2 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.

10.3 It is important to note that this strong balance sheet position is not without risk, and with interest rates set to remain at current levels or increase in the future, the timing and structure of future debt financing will be important in sustaining this position. Higher rates will also act as a constraint on future borrowing, and therefore capital financing capacity, which will need to be considered as part of the Council's capital strategy.

10.4 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.