Manchester City Council
Report for Resolution

Report to:	Executive – 13 February 2019 Resource and Governance Scrutiny Committee – 25 February 2019 Council – 8 March 2019
Subject:	Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy 2019/20
Report of:	City Treasurer

Summary

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2019/20 and Prudential Indicators for 2019/20 to 2021/22.

Recommendations

The Executive is requested to:

1. commend the report to Council.
2. Delegate authority to the City Treasurer, in consultation with the Executive Member for Finance, 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. commend the report to Council.

The Council is requested to:

1. Approve the proposed Treasury Management Strategy Statement, in particular the:
   - Prudential and Treasury Indicators listed in Appendix A of this report
   - MRP Strategy outlined in Appendix B
   - Treasury Management Policy Statement at Appendix C
   - Treasury Management Scheme of Delegation at Appendix D
   - Borrowing Requirement listed in Section 6
   - Borrowing Strategy outlined in Section 9
   - Annual Investment Strategy detailed in Section 10

2. Delegate to the City Treasurer, in consultation with the Executive Member for Finance & Human Resources, 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.

Wards Affected: All

Contact Officers:

Carol Culley City Treasurer Tel. 0161 234 3406
c.culley@manchester.gov.uk

Janice Gotts Deputy City Treasurer Tel. 0161 234 3590
j.gotts@manchester.gov.uk

Tim Seagrave Group Finance Lead – Capital & Treasury Management
Tel. 0161 234 3445
t.seagrave@manchester.gov.uk

David Williams Treasury Manager Tel. 0161 234 8493
d.williams8@manchester.gov.uk

Background documents (available for public inspection):

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

- Treasury Management Strategy Report framework provided by Link Asset Services (Treasury Advisors)

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 highlights 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 there are significant economic changes, such as Britain leaving the European Union, 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.

2. **Statutory and other requirements**

2.1. **Background**

Treasury management is defined by CIPFA as:

'The management of the local authority'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.'

2.2. **Statutory requirements**

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.

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 10 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.

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 2017. CIPFA have also issued Public Services Guidance Notes in 2018 to support the changes made to the Codes.

2.3. **CIPFA requirements**

The CIPFA Code of Practice on Treasury Management (Revised November 2009) was originally adopted by the Council on the 3 March 2010, having been approved by Executive on the 10 February 2010. The Code was revised in November 2011 and in December 2017. The revisions followed consultation with the public sector and were made in response to development of the localism agenda and a sustained period of public spending. This strategy has been prepared in accordance with the revised December 2017 Code.

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 manner in which 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.

The Council's adherence to the Prudential Code is monitored through the series of Prudential Indicators defined by CIPFA. These have recently been subject to revision following a consultation, and this strategy adheres to those revisions. 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.

2.4. **Treasury Management Strategy for 2019/20**

The suggested strategy for 2019/20 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: Statutory and other Requirements
Section 3: Treasury Limits and Prudential Indicators
Section 4: Impact of 2012 HRA reform
Section 5: Current Portfolio Position
Section 6: Borrowing Requirement
Section 7: Treasury Limits and Prudential Indicators for 2019/20 to 2021/22
Section 8: Prospects for Interest Rates
Section 9: Borrowing Strategy
Section 10: Annual Investment Strategy
Section 11: Scheme of Delegation
Section 12: Role of the Section 151 Officer
Section 13: Minimum Revenue Provision (MRP) Strategy
Section 14: Recommendations
Appendix A: Treasury Limits and Prudential Indicators for approval
Appendix B: MRP Strategy
Appendix C: Treasury Management Policy Statement
Appendix D: Treasury Management Scheme of Delegation
Appendix E: The Treasury Management Role of the Section 151 Officer
Appendix F: Economic Background – Link Asset Services
Appendix G: Prospects for Interest Rates
Appendix H: Glossary of Terms
Appendix I: Treasury Management Implications of HRA Reform

2.5. **Balanced Budget Requirement**

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. In particular, 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 to capital expenditure; and
- any 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.

3. Treasury Limits and Prudential Indicators

3.1. The Council must comply with appropriate legislation and have regard to the Prudential Code when setting its Treasury Management Policy and Strategy. Following the issue in 2017 of MHCLG revised guidance on local government investments CIPFA consulted with the public sector and revised the Prudential Code. The changes included:

- the opportunity for an Authority to identify its own prudential indicators to reflect local circumstances.
- cancellation of the requirement for an Authority to formally note that it has adopted the Code.
- extension of the responsibilities of the Treasurer in respect of the Capital Strategy and the investment of non-financial assets. See Appendix E.
- deletion of the Council Tax indicator. This indicator could be fundamentally misleading as it struggled to reflect how borrowing might be taken, or the impact of changes in market conditions.
- clarification that the Code covers all investments held primarily for financial returns. This implies there is no differentiation between investments held for treasury purposes and investments held for commercial purposes.
- withdrawal of the requirement to analyse interest rate exposure or credit risk.

Three existing Indicators were confirmed as being key:
the Authorised Limit (Affordable Borrowing Limit)
the Operational Boundary, and
Actual External Debt from the preceding year

3.2. 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.

3.3. 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.

3.4. 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.

3.5. The full set of Treasury limits and Prudential Indicators recommended by the Code and used by the Council, together with their suggested levels for 2019/20 is noted in Appendix A of this report below.

3.6. It should be noted that the Treasury limits and Prudential 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.

4. The Housing Revenue Account - Impact of 2012 HRA reform

4.1 The Local Government Finance and Housing Act 1989 requires Councils who own housing they rent out to tenants to separate all of 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.

4.2 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.

4.3. 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.

4.4. 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.

5. Current Portfolio Position

5.1. The forecast portfolio position for the end of the current financial year is shown below and assumes the novation of the loans relating to the Greater Manchester Housing Investment Fund provided by MHCLG to the Greater Manchester Combined Authority (GMCA) will complete before the end of the 2018/19 financial year. The City Council will retain some elements of the investments which were already committed at the time of the transfer and these loans will be retained until the investments end. The GMCA will support the cashflow of the Council to ensure that the arrangement is cash neutral for the Council. This is reflected in the short term borrowing position shown.

5.2 The forecast portfolio position below assumes that the related MHCLG loan no longer forms part of the Council's debt position and GMCA will provide short term borrowing to cover existing commitments under the Housing Investment Fund. It also reflects £150m of PWLB borrowing has been taken this financial year to support the Council's cash flow.

5.3 The Council's forecast treasury portfolio position at 31 March 2019 is:

Table 1		**Principal**			**Av Rate**
		GF £'m	HRA £'m	**Total £'m**	%
Long Term Borrowing					
	PWLB	150.0	0	**150.0**	2.45
	Market	338.0	62.2	**400.2**	4.50
	Stock	0.9	0	**0.9**	4.00
SALIX	Government	11.4	0	**11.4**	0.00
HCA	debt	8.4	0	**8.4**	0.00
		508.7	62.2	**570.9**	3.80
Short Term Borrowing		113.0	0	**113.0**	0.01
		113.0	0	**113.0**	
Gross debt		**621.7**	**62.2**	**683.9**	3.17
External Investments		0	0	**0**	0.00
Internal balances (GF/HRA)		34.5	(34.5)	**0**	0.00
Net debt		**656.2**	**27.7**	**683.9**	
Capital Financing Requirement				**1,488.5**	
Gross Debt				**683.9**	
Internal Borrowing				**804.6**	

5.3. 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 means capital expenditure incurred but not yet paid for.

5.4. The Capital Financing Requirement of the City Council excluding credit arrangements as at 31 March 2019 is forecast to be c.£1,488.5m. The difference between this and the actual gross debt of the Council is c.£804.6m which is the amount of funding that the Council has internally borrowed. This is a reflection of the treasury strategy where internal cash has been utilised to reduce the amount of borrowing required rather than holding this cash as investments. In 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 the timing of receipts and payments.

5.5. As part of the reform of the HRA, on the 28th March 2012 the then DHCLG repaid all of 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.

5.6. The portfolio at 31 March 2019 includes Council Stock with a value of £0.86m. 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.

5.7. The portfolio above includes the funding from the GMCA for previous investments made by the City Council for the Housing Investment Fund. During the year repayments from the investments may be received and the Council will reduce the short term funding from the GMCA accordingly. Similarly if these loans require further advances the funding from the GMCA will increase.

6. Borrowing Requirement

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

Table 2	2019/20	2020/21	2021/22
	£'m estimate	**£'m estimate**	**£'m estimate**
Planned Capital Expenditure funded by Borrowing	153.1	179.7	174.5
Change in Grants & Contributions	-5.1	48.8	2.6
Change in Capital Receipts	3.3	28.8	-0.7
Change in Reserves	16.1	32.7	19.6
MRP Provision	-24.8	-31.3	-37.0
Refinancing of maturing debt (GF)	2.8	2.2	4.7
Refinancing of maturing debt (HRA)	0.2	0	0.5
Estimated Borrowing Requirement	145.6	260.9	164.2
Funded by:			
GF	145.4	260.9	163.7
HRA	0.2	0	0.5

6.2. The borrowing detailed in Table 2 maintains the Council within the revised Government Debt Deal limit. The current Debt Deal expires in 2019/20 and it is not clear what will happen for the next Spending Review Period.

7. Prudential and Treasury Indicators for 2019/20 to 2021/22

7.1. Prudential and Treasury Indicators (as set out in Appendix A to this report) are relevant for the purposes of setting an integrated treasury management strategy.

8. Prospects for Interest Rates

8.1 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 a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following gives Link's central view:

Link Asset Services Bank Rate forecast for financial year ends (March)

- 2019: 0.75%
- 2020: 1.25%
- 2021: 1.50%

8.2 There is no certainty to these forecasts. The Bank of England increased Base Rate from 0.50% to 0.75% on 2nd August 2018. Base Rate had previously remained static at 0.50% since March 2009, albeit for a reduction in August 2016 to 0.25%. This was later reversed in November 2017 when the rate was reinstated to 0.50%. In November 2018 the Governor of the Bank of England predicted that future rate rises will remain "gradual", but indicated that there will be a need to raise the Rate to 1.5% over the next three years to keep inflation under control. In addition there was a suggestion that the next Rate change could be either up or down dependent on the outcome of the Brexit arrangements. A detailed view of the current economic background prepared by Link is at Appendix F to this report.

8.3 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.

8.4 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.

9. Borrowing Strategy

General Fund

9.1. 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 means the Council will need to undertake external borrowing in the future and will not be able on to rely on internal borrowing alone. The first tranche of external borrowing was taken from the PWLB in quarter 4 of 2018/19. Where possible, internal borrowing will remain the first option due to the interest savings generated.

9.2. The Council's borrowing strategy must 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.

9.3. In previous years this has not been an issue as the Council has had significant borrowing requirements year on year which have allowed it to utilise the MRP. However the borrowing requirement may fall in the long term so a prudent strategy is to seek to borrow in the medium term with maturities to match the estimated MRP that is generated in that 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.

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

9.5 The Council will continue to use its 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.

HRA

9.6 The Council's proposed capital budget for 2019/20 and beyond does not contain any requirement for the HRA to borrow. It is expected that proposals will be brought forward to build new homes that require funding via borrowing so it is likely the HRA will have a borrowing requirement in 2019/20. Further details can be found in the HRA Business Plan report elsewhere on the agenda. The level of borrowing affordable is restrained by the statutory requirement for the HRA Business Plan to avoid going into a deficit.

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. This is discussed further in Appendix I.

9.8 Note, in the event that 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 As stated above the Council's borrowing strategy will firstly utilise internal borrowing. However as the overall forecast is for long term borrowing rates to increase the short term advantage of internal and short term borrowing will be weighed against the potential cost if long term borrowing is delayed as rates for longer term loans are expected to increase.

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.

i Public Works Loan Board (PWLB)

PWLB borrowing is available for 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 March 2012 Budget the Chancellor announced the availability of a PWLB 'Certainty Rate' for local authorities which could be accessed upon the submission of data around annual borrowing plans for individual authorities. The Council submitted its return in April 2018. The Certainty Rate allows a local authority to borrow from the PWLB at 0.20% below their published rates.

The Government has also introduced a PWLB Infrastructure Rate to be borrowed at 0.40% below their published standard rates. There is a bidding process to access this rate and preference given to projects displaying high value for money. There are two bidding rounds each year, one runs from 1st May to 31st July 2018 and the second is from 1st January to 31st March 2019.

These reductions, alongside the flexibility the PWLB provides in terms of loan structures and maturity dates together with the current lack of availability of market debt options, suggest that should long term borrowing be required PWLB borrowing might provide the best value for money.
The Link forecast for the PWLB Certainty Rate is as follows:

Table 3	Mar 19	Jun 19	Sep 19	Dec 19	Mar 20	Mar 21
Bank Rate	0.75%	1.00%	1.00%	1.00%	1.25%	1.50%
5 yr PWLB rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.60%
10 yr PWLB rate	2.50%	2.60%	2.60%	2.70%	2.80%	3.00%
25 yr PWLB rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.40%
50 yr PWLB rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.20%

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

ii European Investment Bank (EIB)

The EIB's rates for borrowing are generally favourable compared to PWLB although the margin of benefit has now reduced. Rates can be forward fixed for borrowing from the EIB 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.

iii 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.

iv Housing Investment Funding and the Homes and Communities Agency

Both HIF and HCA are MHCLG funding and only used in specific circumstances, see paragraphs 9.12-16 for further details.

v Inter-Local Authority advances

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

vi Market Loans

There are usually various offers available from the general market including LOBOs or forward starting loans. The Council will give consideration to forward fixing debt, whereby it agrees to borrow at a point in the future at a rate based on current implied market interest rate forecasts.

vii 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.

Although the Agency's aim is to raise finance for Local Authorities by issuing municipal bonds to capital markets, at the time of writing the first bond has yet to be issued. 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.

Homes and Communities Agency Funding

9.13 The Homes and Communities Agency (HCA) has made £31.8m funding available to the City Council and this was received during the three years 2015/16 to 2017/18. The funding is, in effect, a 'loan' of the HCA's receipts from the disposal of its land and property within Greater Manchester (GM) as agreed in the GM City Deal. The funds can be used to invest in any project which supports GM City Deal objectives. Some of the funds are passed on to other GM authorities for projects within their areas.

9.14 The funding from the HCA is held as an interest free loan until an investment approval is made. At this point the approved element of the loan becomes risk-based with the return to the HCA based on the performance of that investment. The location of the project depends on where the receipts originate from and whether the receipt is due to the sale of residential or commercial property. Proceeds from commercial property are not borough-specific, whereas proceeds from residential property are.

9.15 The funds received are to be repaid to the HCA in March 2022. No interest will be charged to MCC for the receipt of the funds. Should an investment made not be recovered, the loss is deducted from the amount due to the HCA. Conversely, should any profit be made by an investment these will be added to the amount due to the HCA.

Housing Investment Funding (HIF)

9.16 The Council has arranged with the Homes and Communities Agency to receive housing investment funding on behalf of Greater Manchester. The funds are treated as a loan to the Council in a similar manner to HCA funds as detailed in paragraphs 9.12-14. These monies are then be invested in housing related projects with any losses met by Government (up to 20%) or by guarantee from the ten Greater Manchester Local Authorities (including Manchester). All the Housing Investment Fund schemes are approved by the GMCA and the Council's role is to act as a host for the financial arrangements.

9.17 Total HIF funding of £300m has been agreed with the MHCLG of which £197.7m has been received to date. The majority of HCA and HIF funds are expected to transfer to the GMCA in quarter 4 2018/19 following the Authority being granted the statutory borrowing powers required. The element of the investment which was already committed at the time of the transfer is being retained by the Council until the investment completes.

Sensitivity of the forecast

9.18 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

9.19 The current borrowing position reflects the historic strong Balance Sheet of the Council as highlighted in Section 5. The policy remains to keep cash as low as possible and minimise temporary investments.

9.20 The next financial year is again expected to be one of historically low 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.

9.21 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.

9.22 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 significantly higher. Consideration will also be given to forward fixing rates whilst rates are favourable.

9.23 Against this background caution will be adopted within 2019/20 treasury operations. The 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

9.24 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.

9.25 This Council will not borrow in advance of need to on lend. 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 plans 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

9.26 The Council will give consideration to 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 it can be beneficial as it avoids the need to borrow in advance of need and suffer cost of carry. 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

9.27 It is likely that opportunities to reschedule debt in the 2019/20 financial year will be limited particularly as the Council has no existing PWLB loans other than those expected to be taken in the last quarter of 2018/19.

9.28 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 compared to the current rates of longer term debt in the existing portfolio.

9.29 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 relates 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.

9.30 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)

9.31 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 City Treasurer the authority to pursue any restructuring, rescheduling or redemption opportunities available.

9.32 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.

9.33 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 City Treasurer will be asked to approve them in accordance with her delegated powers and the changes will be reported to Members.

10. Annual Investment Strategy

General Fund

Introduction

10.1. The Council will have regard to the MHCLG's Guidance on Local Government Investments (the Guidance) and the 2011 and 2017 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.

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

10.3. 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.

10.4. The Icelandic banks crisis and the financial difficulties faced by UK and international banks that followed have placed security of investments at the forefront of Treasury Management investment policy. Similarly the move in the local authority sector to commercial investment had led to a reinforcement of these principles under the revised Prudential Code.

10.5 The Council's TMSS focusses solely on treasury management investments. CIPFA has revised the Prudential Code to strengthen disclosure requirements for investments which are commercial in nature, in that they are neither treasury or strategic capital 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.

Changes to Credit Rating Methodology

10.6. Through much of the financial crisis the main rating agencies provided some institutions with a ratings 'uplift' due to implied levels of government backing should an institution fail. In response to the evolving regulatory regime and the declining probability of government support the rating agencies are removing these 'uplifts'.

10.7. The changes do not reflect any changes in the underlying status of the institution or credit environment, merely the removal of the implied levels of sovereign support built into ratings during the financial crisis. The regulatory and economic environments now mean that financial institutions are much stronger and less prone to failure in a financial crisis.

10.8. The key change to the regulatory framework in respect of banks was introduction of the European Union's Banking Recovery and Resolution Directive (BRRD). In response to the banking crisis some governments used taxpayer funds to support banks. BRRD now requires 'bail-in' to be applied in such a scenario. In the UK this requires that after shareholders' equity, depositors' funds over c.£85k (linked to the Euro) will be used to support a bank at risk. The £85k threshold is not available to local authorities and all bank deposits are at risk of bail-in. This increases the risk to the Council of holding unsecured cash deposits with banks and building societies.

Investment Policy

10.9. As previously, 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.

10.10. Investment in banks and building societies are now exposed to bail-in risk as described above and lower operational limits for these investments were adopted in 2016/17. This is apart from 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 2018/19 will be maintained in 2019/20.

10.11. The investment constraint brought by bail-in risk means the Council has sought to identify ways that it can broaden and diversify its basis for lending. During 2018/19 the Council decided to reduce its exposure by maintaining a lower level of bank deposits. This strategy saw a significant proportion of the Council's investments placed with the Government (via the DMO) or with other Local Authorities.

10.12 From October 2018, in line with the 2018/19 TMS, the Council has started to deposit in Money Market Funds (MMFs) to further diversify the basis for lending, using four MMFs which meet the Council's TMSS criteria. Although MMFs are not directly exposed to bail-in risk there could be a secondary exposure related to the extent that the individual Fund includes bank deposits within its portfolio of investments. Application of bail-in in this scenario would impact on the overall status of the Fund and it is likely that the Council would be able to withdraw from participation in the Fund in such a situation.

10.13 To December 2018 the majority of the investment portfolio was with the DMO and other Local Authorities. For liquidity purposes an average of £15m has been held in Bank Deposits and from October 2018 Money Market Funds deposits have averaged £20m. This highlights the relatively low credit risk that the Council takes when investing.

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

10.14. For 2019/20 investment the Council will continue to consider trading 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 paragraphs 10.32-36 below. Treasury Bills, Certificates of Deposit and Covered Bonds 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. Work is continuing to open further access points to markets and to identify opportunities for benefit which are new to the Council.

10.15. 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.

HRA

10.16. 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.

Specified and Non-Specified Investments

10.17. 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.

10.18. 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.

Table 4	Minimum ‘High’ Credit Criteria	Use
Term deposits – banks and building societies*	See Para 10.9.	In-house
Term deposits – other Local Authorities	High security. Only one or two 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_M	In-house
Treasury Bills	UK Government backed	In-house
Covered Bonds	AAA	In-house

* 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 10.23. If this limit is breached, for example due to significant late receipts, the 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.

Creditworthiness policy

10.19. The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings 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

10.20. The above are combined in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. This classification is called durational banding.

10.21. 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 preponderance to just one agency's ratings.

10.22. 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 on a daily basis 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[2] 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.

10.23. 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

[2] 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 Capita Asset Services' Credit List.

10.24. 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.

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

In seeking to diversify he 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	£60 million
Certificates of Deposit	£25 million
Covered Bonds	£25 million

10.25. 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 City Treasurer and any increase in the limits will be reported to Members through the normal treasury management reporting process. Any HCA funds invested with other local authorities will form part of the £20m limit noted above.

Country Limits

10.26. The introduction of bail-in arrangements means that the Council's exposure to bank and building society deposits should be limited and these deposits will only form part of a diversified investment portfolio to help mitigate the risk.

10.27. Previously the Council's treasury management strategies included investment limits to specific countries, such as those rated AAA. The introduction of bail-in arrangements suggests that less reliance can be placed on sovereign support for individual institutions and the country limits have been removed. The focus of credit rating evaluations will be on the individual banks, building societies and organisations.

Money Market Funds

10.28. 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.

10.29. 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. The majority of money market funds invest both inside and outside the UK. MMFs also provide flexibility as investments and withdrawals can be made on a daily basis.

10.30. 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 based.

10.31. 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 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.

10.32. For international investments the Council requires that the countries concerned must possess AAA status if there is a direct investment in a sovereign state. This is not applicable to MMFs. Whilst MMFs invest outside the UK their investment risk is identified on the basis of the total Fund rather than the ratings of the individual components within it. Should a country (or institution) become a higher risk in a MMF portfolio the Fund's management will seek to realign the investment portfolio to maintain the MMF's overall credit rating.

Treasury Bills

10.33. 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.

10.34. Weekly tenders are held for Treasury Bills so the Council could invest funds on a regular basis. This would provide a spread of maturity dates and reduce the volume of investments maturing at the same time.

10.35. There is a large secondary market for Treasury Bills so it is possible to trade them in earlier than the maturity date if required and to purchase them in the secondary market. In the majority of cases the Council will hold to maturity to avoid any potential capital loss from selling before maturity and will only sell the Treasury Bills early if it can demonstrate value for money in doing so.

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 sufficient 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 2019/20 is estimated to range between £0m and £230m. 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 forecast Bank Rate is noted at Section 8. The current economic outlook is that the structure of market interest rates and government debt yields have several key treasury management implications:

- The Bank of England has adopted a more aggressive tone in its provision of guidance to financial markets. The Bank has indicated there will be a need to gradually raise the Bank Rate to 1.5% over the next three years to keep inflation under control.

- Link's view is that Bank Rate will continue at its current rate of 0.75% until June 2019 when a rise to 1.00% is predicted. Thereafter rises to 1.25% in

March 2020, 1.50% in December 2020 and to 1.75% in June 2021 are forecast.

- Forecasting as far ahead as 2021 is difficult as there are many potential economic factors which could impact on the UK economy. There are also political developments in the UK, (especially over the terms of Brexit), EU, US and beyond which could have a major impact on forecasts;

- Investment returns are likely to remain relatively low during 2019/20 and beyond;

- Growth in the Eurozone after several years of depression following the financial crisis started to improve from 2016 and now has substantial strength. However the European Central Bank is struggling to achieve its 2% inflation target and therefore rates will possibly not start to rise until 2019.

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.

10.40. 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.

10.41. For 2019/20 it is suggested the Council should target an investment return of 0.50% on investments placed during the financial year. For cash flow generated balances the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of year Investment Report

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

Policy on the use of External Service Providers

10.43. 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 remains with the organisation at all times and will ensure that undue reliance is not placed upon its external service providers.

10.44. 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 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 page 1 of the report for the list of recommendations.