Open Report on behalf of Andrew Crookham,
Deputy Chief Executive & Executive Director – Resources

Report to:	**Overview and Scrutiny Management Board**
Date:	**29 February 2024**
Subject:	**Treasury Management Performance 2023/24 - Quarter 3 to 31 December 2023**

Summary:

This report details the treasury management activities and performance for Quarter 3 of 2023/24 to 31st December 2023, comparing this to the Treasury Management Strategy and Annual Investment Strategy 2023/24 that was approved by the Executive Councillor for Resources, Communications and Commissioning on 13 March 2023. This report meets the reporting requirements as detailed in the CIPFA Code of Practice for Treasury Management that the Council follows.

Actions Required:

The Overview and Scrutiny Management Board is invited to review the report and pass any comments onto the Executive Councillor for Resources, Communications and Commissioning.

1. Background

1.1. The Treasury Management Strategy and Annual Investment Strategy 2023/24 sets the framework for how we manage the cashflow, borrowing and treasury investments of the Council and the risks involved.

1.2. Actual activity and performance compared to this strategy is reported quarterly, this report being the third quarter report for 2023/24 covering the period up to 31st December 2023.

1.3. Activity and performance up to 31st December 2023 compared to the Strategy is detailed in the Conclusion in Section 2 below. Supporting information is detailed in the attached appendices.

2. Conclusion

<u>Comparison of Activity and Performance to Strategy for Period up to 31st December 2023</u>

Interest Rate Forecast:

***Strategy*:**

At the time of writing the Strategy:

- *By Qtr4 of 2022/23, the Bank of England's Monetary Policy Committee (MPC) had increased Base Rate nine consecutive times from 0.50% to 3.50% to combat on-going inflationary and wage pressures and two more increases left Bank Rate at 4.25% at the end of the financial year.*
- *Further **increase in Bank Rate** was forecast **to peak at around 4.50% by May 2023, then fall back gradually from this point to end the year around 4.00%** and to 2.50% by December 2025. This forecast was linked to inflation falling back over the year as predicated so that the MPC could loosen monetary policy to promote growth.*
- ***Long term rates** were in the region of 4.10% to 4.70% over different periods and were **expected to fall gradually, by around 0.30% to 0.40% in 2023/24,** in line with the expectation for falling inflation.*
- *This forecast was linked to the expectation of inflation falling back over 2023/24 from its highs of over 10%. Growth was expected to contract in 2023/24 due to increases in interest rates and the cost of living squeeze, and the MPC was thought to be keen to reduce rates again as soon as inflationary pressures eased to promote growth.*

Activity and Performance to 31st December 2023:

Short term Rates.	The MPC kept Base Rate on hold in December for the third time in a row at 5.25% despite softer wage and inflation data. Both the markets and Link Asset Services, (our Treasury Advisor), think that **Base Rate has now peaked at 5.25%**, with cuts to Base Rate next expected by September 2024. **A fall to 3.75% is forecast by the end of 2024/25**, reaching 3.00% by 2026.
Long Term Rates.	The movement in gilt yields, which impact long-term borrowing rates, have mirrored the revised fall in Bank Rate at the shorter end of the yield curve (5yrs to 10 yrs). Medium to long term rates (15yrs to 50yrs) are also influenced by the outlook for inflation and the market appetite to purchase gilts, hence they too have fallen alongside expected inflation falls. **PWLB 5 year to 50 year rates were in the range of between 4.19% to 4.68% at the end of December 2023** but have since risen to 4.56% to 5.08% respectively at the time of writing. Link expect rates to gradually fall by December 2026 to the region of **3.50% to 3.90%.**

Economic Review.	Inflation (CPI) in the UK fell to 4% in December, in line with expectations, as the high energy price cap fell out of the data. Economists are expecting inflation to **fall to the MPC target of 2% by April 2024** which has convinced markets that Base Rate will be cut sharply in the second half of 2024. Growth (GDP) in 2023 stayed at 0.5% and forecasts for 2024 were revised down to 0.00% (from 0.50%) by the MPC. Economists expect there may only be the lightest of recessions or possibly not at all, citing the robustness and resilience of the UK economy. Wage growth has also started to fall moderately alongside the reduction in CPI. Inflation, wage inflation, the general election, worldwide conflicts and a weakening pound are all risk factors that will influence the expectations for growth and interest rates going forward, making any forecasts volatile and difficult to predict.

Appendix A shows a graph of key interest rate movements in 2023/24 to date, together with the interest rate forecast and commentary from Link Asset Services Ltd (TM Advisor) dated 8th January 2024 which goes into more detail on the upside and downside risks to current forecasts.

Investments:

***Strategy*:**

- *Investment priority – security first, liquidity second and finally yield.*
- *Aim to invest in all periods up to two years to suit direction of interest rates, at rates in excess of market levels.*
- *Low risk counterparty strategy adopted: minimum long-term rating for approved counterparties set at 'A' and Sovereign Rating of 'AA-' for any two from three credit rating agencies.*

Activity and Performance to 31st December 2023:

Investment Position and Performance.	Cash balances were just above £268m on 31st December 2023. This level is expected to fall by the end of 2023/24, as capital spending increases, which will be funded by Internal cash resources. (Internal Borrowing). The Councils Weighted Average Maturity or **WAM fell to 96 days (from 121 days) at 31st December 2023**, as longer term investments were restricted because cash balances are predicted to fall and liquidity tighten.

Investment return for the period has **increased to 5.057%,** reflecting the rising interest rate environment. This was **above the new SONIA benchmark return of 5.002% by -0.055%.** With Base Rate increases now on hold and the next movement expected to be a cut, the lag of MMF Returns to SONIA has now disappeared as Fund Returns have caught up with market levels. (Note: the SONIA rate is reduced by 0.10% to account for the lack of a bid-offer spread in the market rate).

The Council's return on 31st December 2023 also **exceeded other Councils in the Link Benchmarking group and the English Counties Benchmarking group,** even as the WAM in all groups has fallen. It is expected, however, that performance will be impacted going forward as long term strategic investments will be restricted to maintain adequate levels of liquidity and cash balances fall towards the end of the financial year. For more detail on Investment activity see **Appendix B.**

Lending List Changes and Annual Investment Strategy.

In accordance with the Annual Investment Strategy, maximum amount limits have been set to align with maximum average cash balances of up to £300m. There have been no breaches in Investment limits during the quarter. Improvement in the credit rating for National Bank of Canada has led to improved lending limits for the bank during the quarter from £20m/6 months to £25m/365 day. There has been no changes to the Annual Investment Strategy that sets the Council's investment risk appetite. The Lending List as on 31st December 2023 is shown in **Appendix C**.

Appendix D shows a full list of investments held on 31st December 2023, provided by Link Asset Services (TM Advisor).

Borrowing:

***Strategy*:**

- *Long term external borrowing at start of year was £467.8m, costing 3.725%.*
- *New borrowing requirement for 2023/24 to finance capital programme was set at £77.496m.*
- *Regard is made to the Debt Liability Benchmark for 2023/24, before any new borrowing is undertaken, taking into consideration the cash balance of the Council. As per the Strategy Report, no external borrowing is necessary in 2023/24 to meet the Debt Liability Benchmark.*
- *Any external long-term borrowing, if undertook, would be taken with the aim to reduce the overall cost of debt and for periods to ensure an even debt maturity profile.*

Activity and Performance to 31st December 2023:

Revised Borrowing Requirement.	Borrowing requirement brought forward from 2022/23 brings the balance of Borrowing Requirement at 31st December 2023 to £127.315m. Adjustment for target, changes, rephasing, grants and contributions, Internal borrowing and voluntary repayment of debt will bring this requirement down to zero and **no external borrowing will be undertaken to meet the Debt Liability benchmark for the year**, although the latest Debt Liability Benchmark, as shown in **Appendix E**, shows that external borrowing will be required in 2024/25 to maintain a chosen cash position for liquidity of £100m. The benchmark will be consistently revised for changes in budget and outturn figures going forward and the strategy amended if appropriate to suit market conditions. With borrowing rates forecast to fall, the decision to delay external borrowing is supported by market conditions at present.
Borrowing Position and Performance.	Debt maturing during the period has brought the balance of borrowing at 31st December 2023 to £459.439m at a cost of 3.717%. As no external borrowing will be undertaken in the year the balance of debt outstanding at the year-end is forecast to be £457.439m, at a reducing cost of 3.713%. A total of £10.329m debt will be maturing naturally in 2023/24 and will not be replaced.
Temporary Borrowing.	No temporary borrowing was taken in the period for liquidity purposes and no temporary debt was outstanding at 31st December 2023.

Debt Rescheduling.	No debt rescheduling was undertaken in the period.
Prudential Indicator Limits 2023/24.	All prudential limits were met with no breaches during the period.

Appendix F shows borrowing detail and latest maturity profile on 31st December 2023.

Other Treasury Issues:

-Statutory Guidance on Minimum Revenue Provision (MRP).

The consultation from the Department of Levelling Up, Housing and Communities (DLUHC) on changes to the Statutory Guidance on MRP was issued on 21st December 2023 with a deadline for responses being 16th February 2024. As expected, proposed changes in the guidance concentrate on ensuring a **prudent debt repayment provision** is made by Councils by ensuring that MRP is calculated using the full capital indebtedness of the authority, known as the Capital Financing Requirement (CFR). Any changes will be effective from 1st April 2024 and it is envisaged that there will be minimal financial impact to Lincolnshire County Council's level of MRP calculated from the proposed changes in the legislation. The Councils' MRP Policy for 2024/25 has been revised accordingly to be compatible with any proposed changes implemented from this review.

3. Consultation

a) Risks and Impact Analysis

Risk and impact analysis for treasury management forms TMP1 of the Treasury Management Practices that are required by the CIPFA Code of Practice. A treasury management risk register details the main risks for treasury management, and this is reviewed annually. Both the TMPs and the risk register are held with the Technical Team of Financial Services.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Movement of Key Interest Rates for 2023/24 to date and Latest Interest Rate Forecast and Commentary from Link Asset Services Ltd
Appendix B	Investments: Activity and Performance on 31st December 2023
Appendix C	Authorised Lending List on 31st December 2023 and Credit Rating Key
Appendix D	Monthly Investment Analysis on 31st December 2023 - Link Asset Services Ltd
Appendix E	Debt Liability Benchmark as at 31st December 2023
Appendix F	Borrowing: Activity and Performance and Long-Term Maturity Profile on 31st December 2023

5. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
Treasury Management Strategy Statement and Annual Investment Strategy 2023/24 - 13/3/2023	
Council Budget 2023/24 - 17/2/2023	

This report was written by Karen Tonge, who can be contacted on 01522 553639 or karen.tonge@lincolnshire.gov.uk.

This page is intentionally left blank