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

Report to:	**Overview and Scrutiny Management Board**
Date:	**29 September 2022**
Subject:	**Treasury Management Performance 2022/23 - Quarter 1 to 30 June 2022**

Summary:

This report details the treasury management activities and performance for Quarter 1 of 2022/23 to 30 June 2022, comparing this to the Treasury Management Strategy and Annual Investment Strategy 2022/23 that was approved by the Executive Councillor for Resources, Communications and Commissioning on 14 March 2022. 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 2022/23 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 first quarter report for 2022/23 covering the period up to 30th June 2022.

1.3. Activity and performance up to 30th June 2022 compared to the strategy is detailed in the Conclusion in Section 2 below. Supporting information is detailed in the attached appendices.

2. Conclusion

Comparison of Activity and Performance to Strategy for Period up to 30th June 2022

Interest Rate Forecast:

***Strategy*:**

At the time of writing the Strategy:

- *Short term rates had increased in the final quarter of 2021/22 as the MPC increased Base Rate to 0.50% from 0.10%, in a measure to tackle rising inflation. Further increases in Bank Rate were forecast for March, May, and November where it was expected to end the year at 1.25%.*
- *Long term rates were expected to remain flat over the year in all periods ranging from 2.30% to 2.60% with little difference between any period as short-term gilts increased with short term interest rates and longer dated gilts were impacted by inflation concerns.*
- *This forecast was based on the backdrop of a stronger economy after Covid, but with CPI inflation forecast to reach a peak of 7.25% in April amid concerns over supply side shortages, a tight labour market and demands for wage increases.*

Activity and Performance to 30th June 2022:

Short term Rates.	The MPC has increased Base Rate in their last five meetings, and at the end of June, Base Rate was at 1.25%, with further increases expected. This was in line with other countries across the world to combat rising inflation worldwide that continues to increase further than first forecast. Link Asset Services, the Council's Treasury Management Advisors, expect the Base Rate to peak at no more than 2.75%, which is lower than markets are forecasting, as they believe the impact of the cost-of-living squeeze on Consumers will contribute to bringing inflation down.
Long Term Rates.	Gilt yields, which impact long-term borrowing rates, have been caught up in the global surge in bond yields triggered by the strong rise in inflation the US in May, and have been on a march upwards since the start of the year. But rates have been volatile over this time, sometimes unexplainable and difficult to predict. This volatility can lead to opportunities for debt restructuring in the future. Link expect long term rates to peak only a little further in the year.
Economic Review.	Economies worldwide have been dominated by the emergence of rising inflation since the start of the year

	brought about by increasing food, energy, and commodity prices because of supply side shortages, the Russian invasion of Ukraine and a tightening labour market. At the end of June 2022, CPI inflation reached 9.1% and was expected to peak at 11%. Central banks have a difficult balancing act to follow in getting inflation down without detriment to growth. The MPC stated they are expecting five quarters of recession starting in Quarter 4 (Q4) 2022 running to the end of 2023.

Appendix A shows a graph of key interest rate movements in 2022/23 to date together with the interest rate forecast and commentary from Link Asset Services Ltd (TM Advisor) dated 21st June 2022.

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 30th June 2022:

Investment Position and Performance.	Cash balances, in the main, have hovered just under £300m throughout the period dropping to £247m on 30th June 2022, some £100m lower than at the same time in the previous year. This fall in cash balance was predicted in the 2022/23 Strategy, following the planned use of cash to finance both the 2021/22 and 2022/23 capital programme to date. Investment return for the period has increased to 0.775%. This is below the new SONIA benchmark return of 1.058%. There are several reasons for this, namely the time lag of existing investments falling out at low rates following a rapid rise in interest rates, the planned reduction of the WAM of the portfolio which fell to 95 days at 30th June 2022 (by restricting investments to a maximum six months over the period) in preparation for following the debt liability benchmark and the questionable suitability of the SONIA rate as a comparable indicator (as outlined in the Strategy report). Note the Council's return on 30th June 2022 was in line with other Councils in the Link Benchmarking group with similar WAM levels. For more detail see **Appendix B.**
Lending List Changes.	In accordance with the Annual Investment Strategy, maximum amount limits have reduced as the average cash

balance drops below £300m. As such the position of three counterparties were in excess of the new limits on 30th June 2022, namely Toronto Dominion, Santander and Australia & New Zealand Banking Group. This situation will rectify itself by 31st October 2022, as investments mature. There have been no changes to credit ratings for Counterparties during the year or no changes to the Annual Investment Strategy that sets the Council's investment risk appetite. The Lending List as on 30th June 2022 is shown in **Appendix C**.

Appendix D shows a full list of investments held on 30th June 2022, combined with the creditworthiness list provided by Link Asset Services (TM Advisor).

Borrowing:

***Strategy*:**

- *Long term external borrowing at start of year was £476.1m, costing 3.733%.*
- *New borrowing requirement for 2022/23 to finance capital programme was set at £114.437m.*
- *Regard will be made to the Debt Liability Benchmark, as it is refined during 2022/23, before any new borrowing is undertaken, taking into consideration the cash balance of the Council.*
- *Any external long-term borrowing 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 30th June 2022:

Revised Borrowing Requirement.	After adjusting for internal borrowing carried forward, rephasing of the capital programme, estimated underspends and voluntary repayment of debt, the borrowing requirement at 30th June 2022 is £51.843m.
Borrowing Position and Performance.	No external borrowing has been undertaken in the period to date as long-term rates have risen and work is still being developed on the new Treasury Indicator known as the Debt Liability Benchmark which will determine the amount to borrow in 2022/23 based on the required level of cash required for liquidity and estimated use of reserves. The cost of the Council's borrowing has fallen to 3.718% due to maturing debt to date.
Temporary Borrowing.	No temporary borrowing was taken in the period.
Debt Rescheduling.	No debt rescheduling was undertaken in the period.
Prudential Indicator Limits	All prudential limits were met with no breaches during

2022/23. the period.

Appendix E shows borrowing detail and latest maturity profile on 30th June 2022.

Other Treasury Issues:

DLUHC – Local Authority Capital Finance Framework: Planned Improvements Amended Proposals Survey 2022

The DLUHC (Department for Leveling Up, Housing and Communities) announced in July 2021 its plans to change the current system of regulation of capital finance that has been in place since 2004 with a view to strengthen the current system while protecting the principles of local decision making. Emphasis is being placed on the risks associated with borrowing for commerical investments.

On 17th June 2022, DLUHC invited particpants of the first conultation to give a view on amended proposals. The deadline for this was 8th July 2022.

Key requirements of the amended proposal are:

Requirement to provide MRP:

- for all capital expenditure in the CFR, including Housing Revenue Account
- for capital loans that are made for a commercial purpose
- for expenditure on assets in the year they become operational

Authorities can opt not to provide MRP for loans included in the CFR if they are:

- capital expenditure
- not commercial loans
- do not have an expected/ actual credit loss on the loan

It has not yet been announced when the new regulations for MRP will be implemented by DLUHC on response to these proposed amendments.

Review of MRP Policy for Inclusion of Recommendations of Recent MRP Review by Link Asset Services - November 2021

Work is underway to cost a proposal to move to the Annuity Method for all Asset lives included in the Capital Programme Borrowing Requirement when calculating MRP, as per the recommendations of the Link review on MRP. This would have the benefit of reducing the total MRP charge in earlier years and increasing the MRP charge to later years. Link has estimated that the potential total MRP saving in Net Present Value terms of this move could be £26m.

Any change to the calculation of MRP will be reflected in a new MRP Policy for 2023/24 agreed at the time of the 2023/24 Budget.

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 in the Corporate Section of Financial Strategy at County Offices.

4. Appendices

These are listed below and attached at the back of the report	
Appendix A	Movement of Key Interest Rates for 2022/23 to date and Latest Interest Rate Forecast and Commentary from Link Asset Services Ltd
Appendix B	Investments: Activity and Performance on 30th June 2022
Appendix C	Authorised Lending List on 30th June 2022 and Credit Rating Key
Appendix D	Investment Analysis Review on 30th June 2022 - Link Asset Services Ltd
Appendix E	Borrowing: Activity and Performance and Long-Term Maturity Profile on 30th June 2022

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 2022/23 - 14/3/2022	Decision - Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 (moderngov.co.uk)
Council Budget 2022/23 - 18/2/2022	Agenda for Council on Friday, 18th February, 2022, 10.00 am (moderngov.co.uk)

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