Lincolnshire COUNTY COUNCIL Working for a better future

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

| | |
|---|---|
| Report to: | **Overview and Scrutiny Management Board** |
| Date: | **24 November 2022** |
| Subject: | **Treasury Management Performance 2022/23 - Quarter 2 to 30 September 2022** |

**Summary:**

This report details the treasury management activities and performance for Quarter 2 of 2022/23 to 30 September 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 seek assurance on the treasury management activities and performance.

**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 second quarter report for 2022/23 covering the period up to 30$^{th}$ September 2022.

1.3. Activity and performance up to 30$^{th}$ September 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 September 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 September 2022:**

| | |
|---|---|
| Short term Rates. | The MPC has increased Base Rate in their last eight meetings to curb the increase in inflation. At the end of September, Base Rate was at 2.25%, 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. At the end of September, the market had priced in further increases of Base to peak at 5.25% in response to the 'fiscal loosening event' of the then Prime Minister and Chancellor on 23rd September to stimulate growth. The MPC increased Base Rate again by 0.75% to 3% on 3rd November 2022, as expected, and stated that the UK is likely to already be in recession and that this could last for two years. The MPC indicated that they expect further increases in Base to come to squeeze out inflationary pressures but that they expected the peak to be around 4.85%, lower than that of the Market and the last forecast by Link Asset Services. This is a result of the recent change in Prime Minister and Chancellor and the reversal of the Fiscal Loosening policies introduced in September. |
| 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 in the US in May, and have been on a march upwards since the start of the year. The graph |

| | |
|---|---|
| | shows that gilts yields rose sharply at the end of September following the Government's fiscal stimulus plans with the 30-year gilt rising from 3.60% to 5.10% as an example. The Bank of England was forced to buy up long dated gilts to restore 'orderly market conditions' and postpone its reduction of its Quantitative Easing program. This and the reversal of the planned fiscal loosening stimulus policies have sought to bring gilt yields back to levels seen before the September increases. Link forecast long term yields to fall again by 2025 but remaining volatile. |
| 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 September 2022, CPI inflation was recorded at 9.9% for August and expected to peak at 10.4 % in November 2022. Unemployment fell to a 48-year low of 3.6% due to a large shortage in labour supply. Central banks have a difficult balancing act to follow in getting inflation down without detriment to growth. The MPC stated recently that they expect a two-year prolonged period of recession which has likely already started. The Autumn Statement will be on 17th November 2022 and is expected to announce measures to fill a hole of up to £50bn, whilst at the same time continue to tackle the inflation problem. |

**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 30th September 2022. Note: this commentary was written before the Government's change of Prime Minister and Chancellor and reversal of Fiscal Policy announced in September.

**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 September 2022:**

| | |
|---|---|
| Investment Position and Performance. | Cash balances, in the main, have hovered just under £300m throughout the period and were £277.3m on 30th September 2022. This is lower than the previous year as 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. In line with the rapid increase in Base Rate, the Investment return for the period has also increased to 1.093%. This is still below the new SONIA benchmark return of 1.503%; the main reason for this being the time lag of existing investments falling out at low rates failing to keep in line with the rapid rise in interest rate benchmarks. Several one-year investments have been made above 5% to lengthen the WAM of the portfolio to 116 days. The interest rate on 30th September was 2.24% and at the time of writing was 3.03%. Link Benchmarking data on 30th September 2022 was unavailable at the time of writing and will be reported on the day of the meeting. **Appendix B** shows the Investment activity and performance dashboard as of 30th September 2022. |
| Lending List Changes. | In accordance with the Annual Investment Strategy, maximum amount limits have reduced as the average cash balance drops below £300m. On 30th September 2022 no lending to Counterparties exceeds these limits. There has been a downgrading in credit rating for Credit Suisse leading to a lowering of limits for this Counterparty, and the Council has no current exposure to this bank. There have been no changes to the Annual Investment Strategy that sets the Council's investment risk appetite during the period, however the UK Sovereign rate of AA- has been put on negative outlook by two of the three agencies recently due to the recent economic turmoil. If downgraded, this will put the UK below the minimum Sovereign Rating limit outlined in the current Investment Strategy. For the 2023 Strategy, to overcome this issue, it is proposed to exclude the UK from this minimum limit. The Lending List on 30th September 2022 is shown in **Appendix C**. |

**Appendix D** shows a full list of investments held on 30th September 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 September 2022:**

| | |
|---|---|
| Revised Borrowing Requirement. | After adjusting for internal borrowing carried forward, rephasing of the capital programme, and voluntary repayment of debt, the borrowing requirement on 30th September 2022 is now £0.00m. |
| Borrowing Position and Performance. | No external borrowing has been undertaken in the period to date as PWLB rates have risen and the new Treasury Indicator known as the Debt Liability Benchmark, which determines the amount to borrow based on the required level of cash required for liquidity and estimated use of reserves, is showing that we are above the benchmark for 2022/23 and therefore are not required to borrow. **Appendix E** shows the Debt Liability Benchmark as of 30th September 2022. The cost of the Council's borrowing on 30th September 2022 has fallen to 3.731% due to maturing debt to date and is forecast to fall to 3.725% at the year end. |
| Temporary Borrowing. | No temporary borrowing was taken in the period. |
| Debt Rescheduling. | No debt rescheduling was undertaken in the period. |
| Prudential Indicator Limits 2022/23. | All prudential limits were met with no breaches during the period. |

**Appendix F** shows borrowing detail and latest maturity profile on 30th September 2022.

## 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 September 2022 |
| Appendix C | Authorised Lending List on 30th September 2022 and Credit Rating Key |
| Appendix D | Investment Analysis Review on 30th September 2022 - Link Asset Services Ltd |
| Appendix E | Debt Liability Benchmark on 30th September 2022 |
| Appendix F | Borrowing: Activity and Performance and Long-Term Maturity Profile on 30th September 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.