Lincolnshire COUNTY COUNCIL Working for a better future

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

Report to:	**Overview and Scrutiny Management Board**
Date:	**30 November 2023**
Subject:	**Treasury Management Performance 2023/24 - Quarter 2 to 30 September 2023**

Summary:

This report details the treasury management activities and performance for Quarter 2 of 2023/24 to 30 September 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 second quarter report for 2023/24 covering the period up to 30th September 2023.

1.3. Activity and performance up to 30th September 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 30th September 2023</u>

Interest Rate Forecast:

***Strategy*:**

At the time of writing the Strategy:

- *By Qtr4 of 2022/23, the 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 it's 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 30th September 2023:

Short term Rates.	To bring inflation down to the target level of 2%, the MPC have increased Base Rate 13 times from 0.25% (December 2021) to 5.25% (3 August 2023). This rapid increase has now been brought to an end and the MPC, at its meeting on the 7 November 2023, kept rates on hold for the second time in a row due to inflation falling to 6.7% in August 2023, (still at this level), and the expectation that it will significantly fall in December to around 5.0% as energy price caps fall out of the calculations. Both the markets and Link Asset Services (our Treasury Advisor) think that Base Rate has now peaked at 5.25%, with cuts to Rate expected next in 2024. A fall to 3% is now expected by December 2026 as inflation is forecast to drop to target levels by then.
Long Term Rates.	Gilt yields which impact long-term borrowing rates, have risen, not fallen, since the Strategy forecast, especially at the shorter end of the yield curve (5yrs to 10 yrs), in line with

	increases in Base Rate. Medium to long term rates (15yrs to 50yrs) are influenced by the outlook for inflation and the market appetite to purchase gilts, hence they have risen in the quarter as inflation remained sticky, but they too are expected to fall alongside inflation falls. **PWLB 5 year to 50 year rates were in the range of between 5.22% to 5.67% at the end of September 2023** and Link expect rates to be in the region of **3.50% to 3.80% by December 2026**. These 2026 figures have increased by around 0.30% from previous forecasts.
Economic Review.	Economies worldwide have been dominated by an environment of rising inflation, rising interest rates and weak growth. Central banks have a difficult balancing act to follow in getting inflation down without detriment to growth. In the UK, CPI is still the highest in the G7 at 6.7% but is expected to fall to around 5% by the end of 2023 and to target levels of 2% by 2026. Growth (GDP) bounced back quickly after the pandemic from pent up demand. So far in 2023 growth has been 0.60% but has now stagnated and was 0% in Quarter 3 . Zero growth is expected until 2025 although this is positive news as a recession was feared. There is cooling in labour market conditions but no evidence that this has led to easing in wage growth yet. Inflation, wage inflation, the general election, worldwide conflicts and a weakening pound are all 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 7th November 2023 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 30th September 2023:

Investment Position and Performance.	Cash balances have fallen to just above £258m on 30th September 2023. This level is expected to fall over the course 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 121 days (from 153 days) at 30th September 2023**, as longer term investments have been restricted because cash balances are predicted to fall and liquidity tighten. Investment return for the period has **increased to 4.877%,** the increase from last year reflecting the rising interest rate environment. This was **just under the new SONIA benchmark return of 4.903% by -0.026%.** With Base Rate increases now on hold, the lag of MMF Returns to SONIA has now disappeared as Fund Returns have caught up with market levels. The SONIA benchmark has therefore not been adjusted for any lag in this quarter. (Note: the SONIA rate is already reduced by 0.10% to account for the lack of a bid-offer spread in the market rate). We will continue to look at the suitability of the SONIA rate as an appropriate benchmark to come up with a suitable adjustment. The Council's return on 30th September 2023 was **on a par with or just exceeded other Councils in the Link Benchmarking group** this quarter**,** even as the WAM has fallen and was above the expected return for the Council's chosen risk profile. However performance will be impacted going forward by the policy to reduce cash investment levels to the Debt Liability Benchmark, as long term strategic investments will be restricted to maintain adequate levels of liquidity and cash balances fall. This quarter's return is already seeing evidence of this happening. 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 £300m. There have been no breaches in Investment limits during the quarter. 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 September 2023 is shown in **Appendix C**.

Appendix D shows a full list of investments held on 30th September 2023, combined with the creditworthiness list 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 30th September 2023:

Revised Borrowing Requirement.

Borrowing requirement brought forward from 2022/23 brings the balance of Borrowing Requirement at 30th September 2023 to £127.315m. Adjustment for target, changes, rephasing, 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 the following three years to 2027/28 by around £50m 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 supports market conditions at present.

Borrowing Position and

Debt maturing during the period has brought the balance

Performance.	of borrowing at 30th September 2023 to £460.091m at a cost of 3.718%. 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.	A total of £11m temporary borrowing was taken in the period to cover a liquidity shortfall at a cost of 5.25%. £5m of this borrowing remained outstanding at 30th September 2023, and has subsequently been repaid on 2nd October 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 30th September 2023.

Other Treasury Issues:

Banking Contract Procurement

The tender procedure for the Council contract for Banking Services which comes to an end on 31st March 2024, has concluded and the contract for a new 5 year contract starting 1st April 2024 has been awarded to the incumbent bank, Barclays Bank plc, subject to contract negotiation.

Expected Legislation Changes

-Statutory Guidance on Minimum Revenue Provision (MRP) and changes to Investment Guidance

We are awaiting another consultation from the Department of Levelling Up, Housing and Communities (DLUHC) on further changes to the Statutory Guidance on MRP and Investment Guidance. The consultation was expected in June 2023 but there is no word on the release date. Any changes are likely to concentrate on the area of MRP relating to non-treasury investments made for capital purposes.

-**Consultation on Local Government Capital Risk Mitigation Measures in the Levelling Up and Regeneration Bill (LUR Bill) – will result in changes to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 and be effective on 1st April 2024.**

This consultation was issued in July 2023 with a deadline for response of 21st September 2023. The LUR Bill was introduced in May 2022 and sets out four risk metrics for Councils in England to complete, which if breached would mean the Council comes into scope of the new powers which provides the government with the flexibility to intercede where appropriate to do so. The consultation sought views on appropriate calculations for the following 4 metrics:-

1. **Total debt (including credit arrangements) compared to financial resources.**
2. **Proportion of capital assets for which Investment has been made mainly to generate a financial return.**
3. **Proportion of total debt (including credit arrangements) which is not from PWLB or other Councils.**
4. **Amount of MRP charged in a financial year.**

Calculations should be appropriate, sufficient, readily calculable, understandable and transparent. Hopefully it is envisaged that most data will be accessible from existing returns and be added to existing prudential indicators going forward.

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 30th June 2023
Appendix C	Authorised Lending List on 30th June 2023 and Credit Rating Key
Appendix D	Investment Analysis Review on 30th June 2023 - Link Asset Services Ltd
Appendix E	Debt Liability Benchmark as at 30th September 2023
Appendix F	Borrowing: Activity and Performance and Long-Term Maturity Profile on 30th June 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	

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