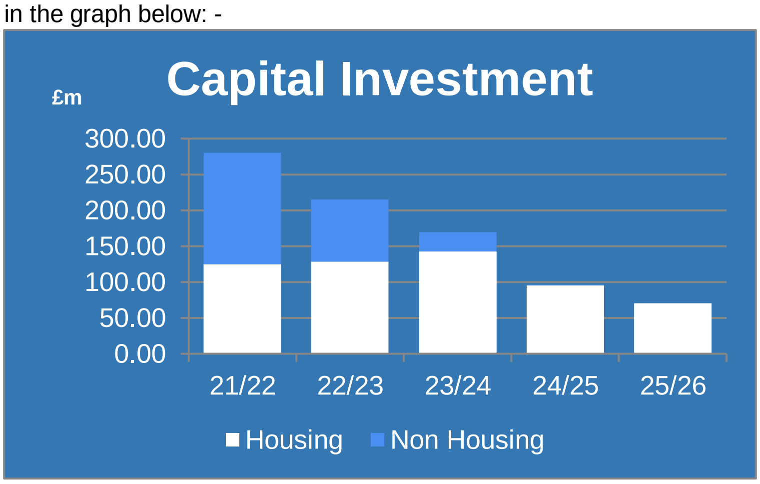
Revenue Implications of Treasury

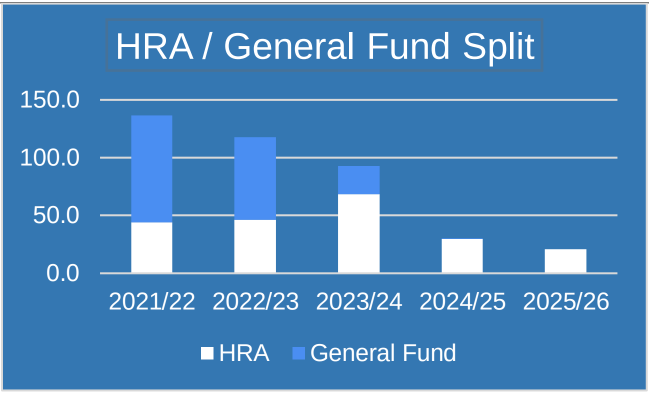
Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 30th September 2021 and the potential implications for revenue budgets.

In addition, Appendix 1 sets out Indicators not already covered in the main report but are required to satisfy the Council's Prudential Code and Treasury Management Code of Practice obligations.

1. Capital Investment & Funding

1.1	**Significant capital investment delivered across the city**	The Council continues to deliver significant capital investment across the city which will provide improved facilities and infrastructure and supports the local economy, whilst ensuring the impact on debt costs within the revenue budget is effectively managed.
1.2	**The capital budget for 21/22 to 25/26 totals £830.5m**	As at 31st August 2021, the approved capital budget, for the period from 2020/21 through to 2025/26 totals £830m (a full breakdown is shown in Appendix A).
1.3	**Housing and non-housing split of planned investment**	The split of this planned investment across housing and non-housing is shown in the graph below: - 
1.4	**Prudential borrowing over the next 5 years will fund approx. 48% (£398m) of capital expenditure**	The proportion of this investment funded by prudential borrowing over this period will be £398m. On this basis, approximately 48% of the capital expenditure planned for the next four years is being funded by Prudential Borrowing – with a substantial proportion of this being Heart of the City II.
1.5	**Graph - Prudential borrowing over next 5 years**	The following graph shows how this element of funding varies over the five years. General Fund borrowing (£188m) makes up to majority of borrowing in the near term, but the HRA forecasts to borrow more from 23/24 onwards



1.6	**The sale of parts of HoTC II programme are expected to be delayed, so borrowing costs and MRP will continue at current levels during this period**	Anticipated disposals of Blocks in the Heart of the City development are now expected to be delayed until more favourable economic conditions help maximise the benefit of the disposal. As a result, assets will be held and financed for longer, meaning the cost of interest and the Minimum Revenue Provision (MRP) charged to revenue will be higher for longer, although these charges will be offset by the rentals received. The gross impact will be around £3.6m (1.6m Interest and £2m MRP costs) though income will offset some of this cost.
1.7	**Additional General Fund borrowing could cost £3.9m from 23/24 onwards, if we decide to borrow for the full programme rather than use our cash balances**	By 23/24 General Fund borrowing could cost an additional £3.9m per year using today's interest rates (2.1%). However strong cash balances suggest some borrowing could be deferred. Delaying borrowing carries a risk that high inflation causes the Band of England to raise interest rates and therefore the long-term cost of borrowing would rise. However deferring borrowing reduces the external interest charges we would pay. Hence depending on what decision we make we may face: • Additional General Fund costs of £3.9m and HRA costs of £4.4m over the forecast period. • MRP charges will increase by £1.3m in 21/22 and further £1.6m in 22/23 as a result of decisions to finance expenditure by borrowing.
1.8	**Prudential borrowing for 21/22 is projected to increase from £114.5m to 136.5m**	The **latest projected** capital expenditure estimates for 2021/22 compared to the original budget position shows that Prudential Borrowing in 2021/22 is projected to increase from £114.5m to £136.5m. The potential impact of this increase is shown in the table below to illustrate how material the increased expenditure could be. In reality MRP isn't charged until the following year, and many HOTC projects are still not live and so MRP can be deferred until completion, so the actual impact is likely to be smaller.

Estimated Additional Revenue Costs	Revised £'000	Original £'000	Variance £'000
Interest Costs (@ 2.1%)	£2,867	£2,405	£462
MRP Costs (assuming a 40 year asset life)	£3,413	£2,863	£550
Potential additional revenue costs	**£6,280**	**£5,268**	**£1,012**

1.9 **Cash balances have remined strong and so we have delayed borrowing**

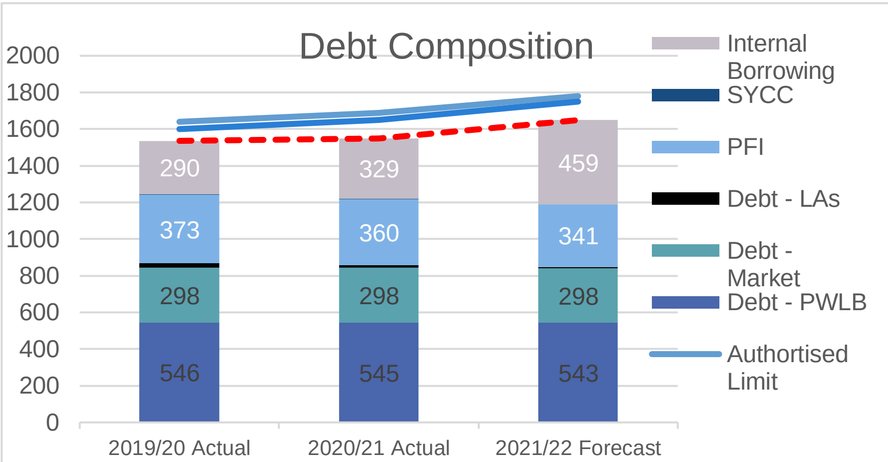
Cash balances have remained strong and have afforded us the luxury of delaying borrowing, potentially into next year. Irregular funding flows from government partially created this opportunity, although uncertainties around Covid costs and movement in borrowing costs mean we approach this strategy with appropriate caution.

2. Update on Debt

2.1 **Current Debt Composition (assumes full years' cap ex in our Capital Financing Requirement – CFR)**

Borrowing from internal sources will increase

This is supported by economic forecasts and low returns on investments. Rising interest rates would put upward pressure on borrowing rates



The above table shows:-

- The Council is using a substantial proportion of its own internally generated cash resources to fund capital expenditure, rather than taking external borrowing. If no further borrowing is externalised the Council will have borrowed internally up to £459m by 31 March 2022.
- This approach is taken because we pay around 2.0% p.a. more to borrow externally than we receive on any cash we invest. This report assumes further internal borrowing, but notes the associated interest rate risk, i.e. rates could be higher in future when we need to borrow externally.
- No new borrowing has been taken since March 20.
- The Council is expected to maintain a moderate amount of borrowing capacity, over and above its current/forecast CFR when compared to the Operational Boundary. Whilst this capacity is forecast to reduce, we do not anticipate breaching the Boundary this year, as we still have a satisfactory margin of safety.

- In addition to that, there is further headroom of circa £30m before borrowing reaches the maximum level currently authorised by Full Council.

2.2 Strategy Update – no proposed changes

There are no proposed changes to:-

- Treasury Management Strategy Statement
- Annual Investment Strategy
- Minimum Revenue Provision Policy
- Either the Operational or Authorised Borrowing Limits

The 2021/22 Treasury Management Strategy Statement (TMSS) set out plans to borrow an additional £111m to fund in-year Capital Expenditure and reduce the under-borrowed position. Strong cash balances have allowed us to defer this borrowing, and should see an estimated £1m in interest costs avoided for 2021/22.

So far this financial year:-

- The timing of grants received to cover Covid related costs have seen our cash balances remain high, although these balances are expected to reduce significantly towards the end of 21/22
- £9.3m of loans will be repaid by March 22
- Only limited further borrowing to fund General Fund investment is anticipated during this financial year, so internal borrowing is expected to increase as per the chart in 2.1
- The HRA is forecasting to expand capital investment which will lead to new borrowing being required., This borrowing may start in late 21/22 depending on the levels of capital expenditure.

2.3 No rescheduling of our borrowing has been undertaken

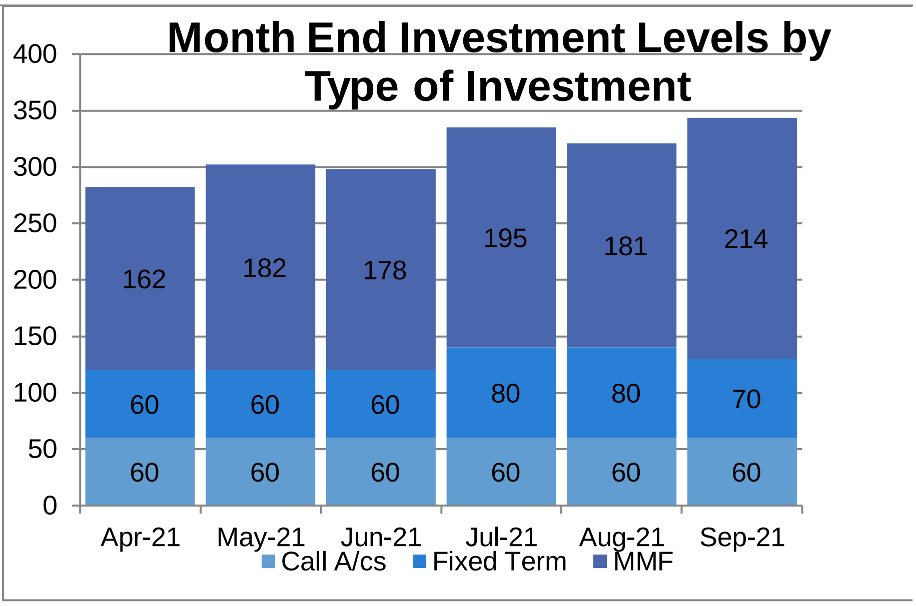
No rescheduling of any of our borrowing has been undertaken. Whilst we will keep this position under review, currently the charges to reschedule PWLB debt are higher than the benefits of doing so, despite the current cheap borrowing levels.

3. Update on Investments

3.1 Investment balances increased by £62m in year but rates of return have stagnated

	Mth End Balance (£M)	Average Return
April 21	£281.8	0.10%
May 21	£302.1	0.10%
June 21	£318.1	0.10%
July 21	£355.1	0.10%
August 21	£320.9	0.10%
September 21	£343.7	0.10%
YTD Ave	£320.3	0.10%

Money Market Funds (MMF's) provide instant access to funds, which is important given current uncertainties



3.2 **High liquidity is being maintained as balances are expected to reduce**

There are no investments for longer than 365 days

Most Local Authorities are in a similar position to Sheffield in that they currently have significant cash balances, this has created excess supply in the LA market and rates for lending are very low. Bank and other investments are showing some very early signs of recovery on expectations the BoE will increase the base rate earlier than previously thought, although any increases are forecast to be slow.

Investment balances are expected to fall toward the end of the financial year.

On this basis, the Council will maintain a mix of investment balances to ensure ready access to funds and where possible benefit from locking away funds for a short fixed duration. We will not pursue yield at cost of the security of funds, this could mean we incur negative yields on some investments, particularly those prioritising liquidity

There are currently no proposals for the Council to invest sums for periods longer than 365 days.

4. Revenue

4.1 **Treasury Management forecast underspend in year, largely from avoiding external borrowing costs**

Interest rate risk increases as a consequence

As at September 2021	Forecast £m	Budget £m	Variance £m
Interest Costs (net of HRA recharge)	20.6	21.6	(1.0)
MRP Costs	18.3	18.5	(0.2)
Budget Variances	**38.9**	**40.1**	**(1.2)**

The above table shows:

- Costs are forecast to underspend compared to budget – as a result of
  - interest savings arising from deferring borrowing and lower interest rates than forecast.
  - lower MRP costs based on underspends against the 2020/21 capital programme.

4.2 **Financing Costs to Net Revenue generally increase slightly**

21/22 shows a decrease as SYCC debt repayments have finished

Ratio of Financing Costs to Net Revenue	2020/21	2021/22	2022/23	2023/24
Finance Costs	£42,666	£39,379	£42,394	£47,953
Net Revenue	£497,759	£528,524	£514,000	£520,590
Ratio	8.57%	7.45%	8.25%	9.21%

** Excluding PFI financing costs and associated grants but includes MRP charges made to services but not included in the treasury management budget*

The above table shows:

- Financing costs generally increase over the period. New borrowing costs have been avoided so far in 21/22, which results in lower costs than budgeted.
- The South Yorkshire County Council (SYCC) debt was fully repaid in 20/21, this is a reduction of around £4.5m in interest and MRP costs.
- Please note that the capital programme projections become less accurate the further forward the projection period is, and therefore financing costs may increase if the amount of the capital programme in 22/23 to 23/24 is funded by prudential borrowing increases.

5. Risk Assessment

5.1 **The principal risks associated with treasury management**

Risk	Mitigation
Loss of investments as a result of a failure of a counterparty	Application of Annual Investment Strategy in relation to choice of counterparty/investment type, level of investment and monitoring of credit ratings
Increase in net borrowing costs due to an increase in borrowing costs and/or a decrease in investment returns	Planning and undertaking borrowing in light of interest rate trends/forecasts. Borrowing using fixed rate loans to limit volatility of interest costs
Interest rates rise significantly, increasing the cost of servicing new borrowing	The planned use of internal borrowing carries a risk that interest rates will be higher when we look to externalise the borrowing.
Fraud	Strong internal controls – with dual stage authorisation for any out-going payments

6. Other Matters

6.1	**Section 151 Officer Compliance**	**The Section 151 Officer confirms compliance with the approved TMSS for 2020/21 and that a prudent investment approach has been followed with priority given to the security and the liquidity of amounts invested over the yield we receive.** **The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2021/22.**

Appendix 1 – Prudential and Treasury Management Indicators

This appendix covers the prudential and treasury management indicators not already covered in the body of the main report but are required under the Prudential Code or the Treasury Management Code of Practice.

Capital Programme and Funding

Forecast as at August 2021	2021/22 Forecast £m	2021/22 Budget £m	2021/22 Variance £m
Non Housing	155.3	99.2	56.1
Housing	125.2	92.5	32.7
Total	**280.5**	**191.7**	**88.8**
Capital Receipts	22.7	11.0	11.7
Capital Grants and Contributions	72.5	25.6	46.9
Revenue Contributions	48.8	40.6	8.2
Prudential Borrowing	136.5	114.5	22.0
Total	**280.5**	**191.7**	**88.8**

Breakdown of Capital Expenditure

Capital Expenditure	21/22	22/23	23/24	24/25	25/26
ESSENTIAL COMPLIANCE & MAINT	8.7	-	-	-	-
HOUSING GROWTH	71.6	70.5	90.8	44.9	23.0
HOUSING INVESTMENT	53.6	57.5	52.2	50.4	47.5
HEART OF THE CITY II	75.7	56.4	6.7	0.0	-
QUALITY OF LIFE	20.3	19.1	17.7	-	-
PEOPLE CAPITAL & GROWTH	21.7	4.6	0.0	-	-
ICT	-	-	-	-	-
TRANSPORT	12.7	0.8	-	-	-
GREEN & OPEN SPACES	3.0	-	-	-	-
ECONOMIC GROWTH	13.4	6.1	1.8	-	-
TOTAL	**280.5**	**215.0**	**169.3**	**95.3**	**70.5**

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	Per TMSS 1248.7	Forecast at end Sept 21 £m
CFR - General Fund CFR	1,248.7	1,259.3
CFR - Housing Revenue Account	395.0	390.0
TOTAL	1,643.7	1,649.3
Borrowing	968.4	848.4
Other Long Term Liabilities	358.1	358.0

Forecast - Total Debt as at 31 March 2022	1326.5	1206.4

Authorised and Operational Borrowing Limits show significant headroom especially compared to external debt.

Authorised and Operational Limits on Debt	Per TMS £m	Forecast £m
Authorised Limit	1,780	1,780
Operational Boundary	1,750	1,750
Projected Year End Capital Financing Requirement	1,644	1,649
Headroom to Operational Boundary (CFR)	106	101
Headroom to Authorised Borrowing Limit (CFR)	136	131
Projected External Debt at 31 March 2022	1,327	1,206
Headroom to Operational Boundary (debt)	423	544
Headroom to Authorised Borrowing Limit (Debt)	453	574

Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, has provided the following forecast. Any increases in rates are forecast to be very slow which supports the strategy of delaying further borrowing. The rates for longer term debt are very similar to where they were 12 months ago. This position will be monitored to ensure it remains prudent.

Market Rates

	Equities				Currencies			Commodities		Risk Indicators	
	FTSE 100	DOW	NIKKEI	STX 600	£/$	€/£	€/$	Brent	Gold	VIX	MOVE
Level	7,146.85	34,496.06	28,231.40	457.53	1.3604	1.1767	1.1561	83.65	1,760.09	20.0000	59.6500
Change	0.72%	-0.72%	-0.94%	0.05%	-0.15%	0.01%	-0.15%	1.53%	-0.17%	6.55%	-2.07%

Interest Rates

O/n	1W	1M	3M	6M	9M	12M	24M	36M	48M	60M	SONIA
0.00	0.00	0.05	0.1	0.2	0.3	0.35	0.9	1	1.1	1.2	0.0507

Average LIBID / LIBOR Rates

7D LIBID	3M LIBID	3M LIBOR
-0.08%	-0.05%	0.08%

PWLB (Includes Certainty Rate)

1y	5y	10y	25y	50y
1.17	1.6	2.01	2.38	2.17

Forward Rates

3M/3M FWD	3M/6M FWD	3M/9M FWD	6M/12M FWD
0.48	0.70	0.85	1.13

Interest Rate Forecasts

Bank Rate	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23
Link	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%
Cap Econ	0.10%	0.10%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5Y PWLB RATE								
Link	1.40%	1.40%	1.50%	1.50%	1.60%	1.60%	1.60%	1.70%
Cap Econ	1.40%	1.50%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%
10Y PWLB RATE								
Link	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%	2.00%	2.10%
Cap Econ	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%
25Y PWLB RATE								
Link	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%
Cap Econ	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%
50Y PWLB RATE								
Link	2.00%	2.00%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%
Cap Econ	2.00%	2.10%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%

PWLB

The sharp fall in PWLB rates in the right-hand chart shows the reduction in the Treasury's margin of 1%, returning margins to their historic norm. Throughout the year borrowing costs have moved up and down quite gradually, though September 21 has seen a sharper increase in rates. This is due to high inflation and the prospects of the bank base rate increasing sooner. As investors look away from Gov Debt to increase their returns, demand falls and the price increases, which is what PWLB borrowing is linked to.

The trend for September 21 onwards does need to be monitored closely, though rates are currently above our Treasury Advisors long term forecast.

PWLB Rates - Tuesday 12 October 2021