Treasury Management Outturn Report 2021/22

Contents Page

Key Messages	Director of Finance and Commercial Services' Overview
All investment and borrowing transactions were in line with the principles approved in the 2021-22 Annual Treasury Strategy Statement and the Annual Ethical Investment Strategy. £50m of new borrowing taken in March 22 the mitigate risk of interest rate increases During 2021/22 Bank of England Base Rates increased from 0.1% to 0.75%. Inflation increased to 6.2%.	The Council is required, under the Local Government Act 2003, to produce an annual review of Treasury Management activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). During 2021/22, the Full Council received the annual Treasury Management Strategy Statement (TMSS), whilst Co-Operative Executive was presented with the 2020/21 Outturn Report and a Mid-Year Treasury Management Update Report. The regulatory environment places responsibility on Members for the review and scrutiny of TM policy and activities. This report is therefore important, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members. <u>The Strategy for 2021/22</u> The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated. Investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February). The Treasury Management Strategy anticipated steady increases in borrowing costs and given Sheffield's under borrowed position (using temporarily available cash balances to delay external borrowing, avoiding interest payments) we expected to take significant borrowing before rates started to rise. Whilst the first half of 2021/22 saw very little increase in borrowing rates the second half of the year was very different. The cost of living crisis started to emerge and high inflation in fuel, energy, and food (all exacerbated by the Russian invasion of Ukraine) put pressure on the BOE to increase its base rate. Very high cash balances have meant that we didn't need to take on new borrowing however, to protect against further interest rate risk the authority did take £50m of new long-term borrowing. Base rates have since risen 3 times to 1% (May22) since the decision was taken to borrow. The Council operated within the Prudential Indicator Limits for 2021/22 set by the authority (see annex for details of limits).

Key Messages

Slippage in major capital investment projects, such as the Heart of the City Programme, has seen the CFR increase slightly less than expected.

No HRA capital expenditure has been financed by borrowing in 21/22 despite a budget of £49m

Within the overall CFR total, the HRA's CFR remains unchanged.

£50m of new borrowing was taken in year.

Investment balances increased as a result of additional Government funding, which included the grant for the £150 tax rebate scheme plus new borrowing taken in March 22.

Outturn Report

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

The CFR grows when the Council uses borrowing to fund capital projects but falls as we put money aside each year to repay that debt. The money we put aside to repay the debt each year is known as our 'minimum revenue provision' (MRP), and mimics depreciation charges that are used in the private sector.

The table below shows the outturn for 2020/21 and 2021/22, and the original forecast for 2021/22 including PFI liabilities.

	2020/21 Actual (£m)	2021/22 Actual (£m)	2021/22 Budget from TMS (£m)
General Fund CFR (non PFI)	844	885	910
General Fund - PFI Liabilities	360	341	338
Overall General Fund CFR	1,204	1,226	1,249
HRA CFR	346	346	395
Total CFR	1,550	1,572	1,644

After adjusting for PFI liabilities of £341m, the overall underlying financing requirement of the Authority is £1,231m (an increase of 3.4% on the 2020/21 figure). This is lower than the increase forecast in the budget.

Actual capital investment for 2021/22 was £151.0m, this is lower than the planned £191.7m set out in the TMSS. Capital Expenditure financed by borrowing was £59.1m, £55.4m lower than anticipated at the start of the year, £49m of this related to HRA expenditure that was not financed by borrowing as initially planned.

Gross external debt, excluding PFI liabilities, has increased by £41m to £589m compared to 2019/20. This is £50m in new loans whist £9m of existing loans matured.

Key Messages:

The UK's Growth saw one of the largest contractions globally during covid followed by a strong bounce. Current economic and geopolitical issues are acting as a strong headwind against growth and the possibility of a technical recession has increased.

UK Base Rates have remained low but increasing in the final quarter, the forecast is for more increases in to 22/23 to tackle inflationary pressure.

Inflation surged above the banks 2% in the second half of the year, initially driven by supply chain problems following Brexit and Covid, then latterly by the Russian invasion of Ukraine and its impact on food and fuel prices.

External Context: The Economy and Interest Rates
Source: Link Asset Services (April 22)

UK. Economy. Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation, now that the CPI measure has already risen to 6.2% and is likely to exceed 8% in April.

Gilt yields fell towards the back end of 2021, but despite the war in Ukraine gilt yields have shot higher in early 2022. At 1.38%, 2-year yields remain close to their recent 11-year high and 10-year yields of 1.65% are close to their recent six-year high. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April utilities prices as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1st April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

Average inflation targeting. This was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and *achieving the 2% target sustainably*". That mantra now seems very dated. Inflation is the "genie" that has escaped the bottle, and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

USA. The flurry of comments from Fed officials following the mid-March FOMC meeting – including from Chair Jerome Powell himself – hammering home the hawkish message from the mid-March meeting, has had markets pricing in a further 225bps of interest rate increases in 2022 on top of the initial move to an interest rate range of 0.25% - 0.5%.

In addition, the Fed is expected to start to run down its balance sheet. Powell noted that the rundown could come as soon as the next meeting in May.

The upward pressure on inflation from higher oil prices and potential knock-on impacts on supply chains all argue for tighter policy (CPI is estimated at 7.8% across Q1), but the hit to real disposable incomes and the additional uncertainty points in the opposite direction.

EU. With euro-zone inflation having jumped to 7.5% in March it seems increasingly likely that the ECB will accelerate its plans to tighten monetary policy. It is likely to end net asset purchases in June – i.e., earlier than the Q3 date which the ECB targeted in March. And the market is now anticipating possibly three 25bp rate hikes later this year followed by more in 2023. Policymakers have also hinted strongly that they would re-start asset purchases if required. In a recent speech, Christine Lagarde said “we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalisation.”

While inflation has hit the headlines recently, the risk of recession has also been rising. Among the bigger countries, Germany is most likely to experience a “technical” recession because its GDP contracted in Q4 2021, and its performance has been subdued in Q1 2022. However, overall, Q1 2022 growth for the Eurozone is expected to be 0.3% q/q with the y/y figure posting a healthy 5.2% gain. Finishing on a bright note, unemployment fell to only 6.8% in February.

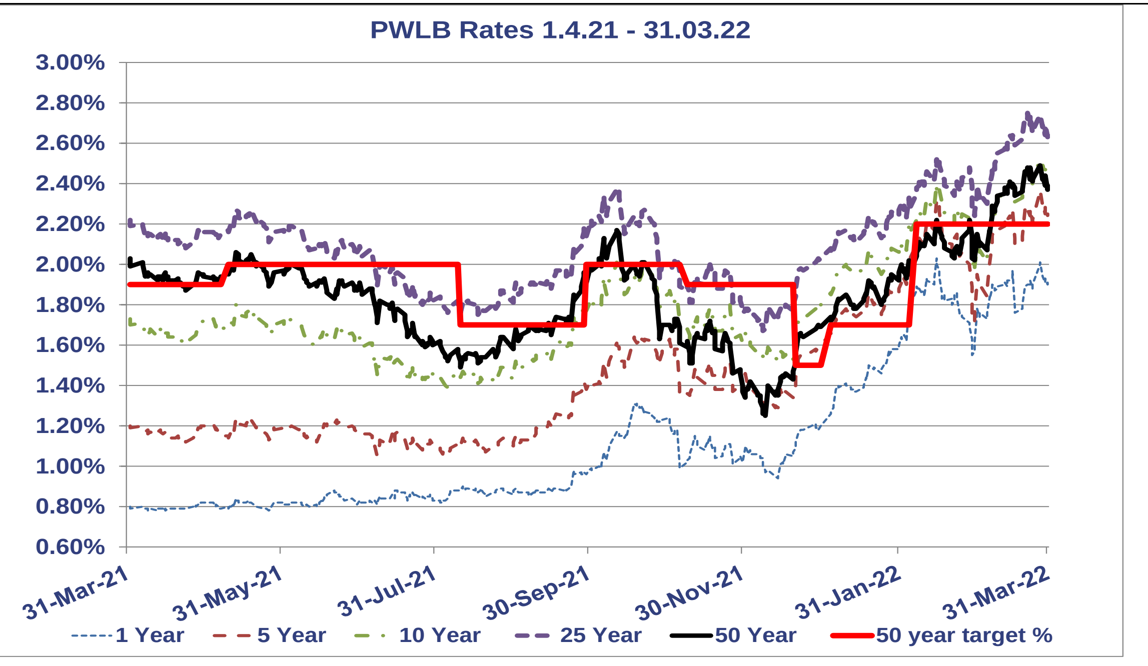
China. After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; however, 2021 has seen the economy negatively impacted by political policies that have focussed on constraining digital services, restricting individual freedoms, and re-establishing the power of the One-Party state. With the recent outbreak of Covid-19 in large cities, such as Shanghai, near-term economic performance is likely to be subdued. Official GDP numbers suggest growth of c4% y/y, but other data measures suggest this may be an overstatement.

World growth. World growth is estimated to have expanded 8.9% in 2021/22 following a contraction of 6.6% in 2020/21.

Deglobalisation. Until recent years, world growth has been boosted by increasing globalisation i.e. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia’s recent invasion of Ukraine, has unbalanced the world economy. In addition, after the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

Central banks’ monetary policy. During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g., full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.

Key Messages:	Borrowing and Investment Rates
Investment rates rose during 2021/22 and the expectation is for further rate rises. The PWLB remain a cost effective source of borrowing the chart on the following page shows rates increasing as the UK Base Rate rises. The Council's investment policy continues to apply a cautious approach, with investments made in low risk counterparties, but with correspondingly low returns.	Investment returns began to slowly increase towards the end of21/22 as the BOE began to increase the Base Rate. Most local authority lending managed to avoid negative rates and one feature of the year was the continued growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2021/22 was that Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates introduced at the start of the Covid-19 pandemic were no longer necessitated. The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the second-round effects of growing levels of inflation (CPI was 6.2% in February). While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the chart shown below. Such an approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets. Interest rate forecasts expected only gradual rises in medium and longer-term fixed borrowing rates during 2021/22 and the two subsequent financial years until the turn of the year, when inflation concerns increased significantly. Internal, variable, or short-term rates, were expected to be the cheaper form of borrowing until well in to the second half of 2021/22.


PWLB Rates 1.4.21 - 31.03.22
3.00%
2.80%
2.60%
2.40%
2.20%
2.00%
1.80%
1.60%
1.40%
1.20%
1.00%
0.80%
0.60%
31-Mar-21
31-May-21
31-Jul-21
30-Sep-21
30-Nov-21
31-Jan-22
31-Mar-22
1 Year
5 Year
10 Year
25 Year
50 Year
50 year target %

Key Messages:

The strategy to reduce under-borrowing was postponed this year due to high cash balance and slippage in the capital programme.

The overall level of capital investment being funded through prudential borrowing is less than originally expected in the TMS.

Borrowing Outturn for 2021/22

The table below shows the breakdown for capital expenditure that should have been financed by external borrowing during the year. SCC externalised a significant proportion of this during 2021/22. The result of this is that the Council's under borrowed position has remained stable. Under-borrowing means that the Council is currently financing some of its capital expenditure from its own cash balances, rather than borrowing externally to fund this expenditure. This exposes the council to higher rates when borrowing is needed, the current environment is for rates to increase slightly. Delaying borrowing is still avoiding costs and allowing time for uncertainty in borrowing requirements to become clearer, EG timing of HOTCII disposals.

	£000	£000
Original borrowing estimate per 21/22 TMS		**114,500**
Expenditure on Schemes creating a Borrowing need:		
Heart of the City	42,000	
Leisure Facilities	15,570	
Essential Compliance	1,579	
Total Borrowing needed:		59,149
Variance to TMSS		**(55,351)**

The 2021/22 TMS aimed to slightly reduce the level of internal borrowing. However, during the year investment balances have dramatically increased and new borrowing would have added to this. The strength of the cash position and the continuing low rate in historical terms allowed further deferral of borrowing.

Under borrowing remains at sustainable levels, but still carries significant interest rate risk – as interest rates do begin to rise. Unaffordable rate increases are not anticipated in the near future however, future rate policy is increasingly hard to predict. High inflation supports a policy of future rate increases, offsetting this is that disposable incomes are falling and higher rates will not affect the cost of living crisis.

Key Messages:	Details of the borrowing taken and repaid in 2021/22 are shown in the table below:

Key Messages:

Net borrowing for the year was £40.7m

Some of the borrowing repaid was short-term borrowing which typically attract lower level of interest rates.

Details of the borrowing taken and repaid in 2021/22 are shown in the table below:

Loan Repayments and Borrowing 2021/22						
New Borrowing				Loans Repaid		
Counterparty	Amount (£000)	term (Years)	Interest Rate (%)	Counterparty	Amount (£000)	Original Rate (%)
PWLB	£15,000	48	2.09	SYMCA	£7,000	2.3
PWLB	£20,000	49	2.09	PWLB	£2,326	10.5
PWLB	£7,500	42	2.21			
PWLB	£7,500	43	2.08			
	£50,000				**9,326**	
Net borrowing	**£40,674**			Net Repayments		

Borrowing rates remain historically low. New borrowing was taken at rate around 0.6% higher than forecast in the Treasury Strategy. Cost of living and high inflation have put pressure on the BOE to increase the UK base rate.

As at 31 March 2021, the loans portfolio, excluding PFI liabilities, totalled £899m, and indicates the Council is under borrowed by £333m – an increase of just £1m on the previous year.

Key Messages:

There has been no debt rescheduled during 2012-22

Investment balances held by the Council were expected to decrease during the year - but this turned out not to be the case.

Investment balances increased by £122m compared to 31 March 2021 – primarily as a result of additional government grant support related to the Coronavirus pandemic.

Investment returns remain subdued – due to market conditions and the policy to invest in low-risk counterparties.

Debt Rescheduling

No rescheduling was done during the year as differential between PWLB new borrowing and premature repayment rates made rescheduling unviable.

Investment Outturn

Ethical Investment Policy

The Council's Investment Policy is set out in the annual Investment Strategy approved by Full Council in March each year. The policy outlines the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data, such as rating outlooks, credit default swaps, etc. In addition, the Council commits to not holding any direct investments in fossil fuels or, to the best of their knowledge, companies involved in tax evasion or grave misconduct.

The investment activity during the year conformed to the approved Investment Strategy.

Investments held by the Council

The Council maintained an average balance of £345m of internally managed funds. As at 31st March 2022, investments were £387m; up £122m on the previous year. The Council had no liquidity difficulties during the year.

The internally managed funds earned an average rate of return of 0.13% compared to 0.23% in the previous year. This should still be judged a good achievement given the state of the market, and the base rate was just 0.1% for most of the year.

The Council would not plan to have such high cash balances under normal circumstances, the timing and amount of Government grants has created the situation. It is expected cash balances will slowly fall, though there remains much uncertainty as to how Central Government will fund Local Authorities for their medium-term Covid-19 pressures.

Annex 1: Outturn Position with General Fund & HRA Split

Authority	31 March 2021 Principal	Rate/ Return	31 March 2022 Principal	Rate/ Return
Total debt	858	*3.92%*	898	*3.90%*
CFR	1,190		1,231	
Over / (under) borrowing	-332		-333	
Total investments	265	*0.23%*	387	*0.13%*
Net debt	593		511	

General Fund	31 March 2021 Principal	Rate/ Return	31 March 2022 Principal	Rate/ Return
Total debt	579	*3.56%*	620	*3.56%*
CFR (excluding PFI)	844		885	
Over / (under) borrowing	(265)		(265)	
Total investments	265	*0.11%*	387	*0.11%*
Net debt	314		233	

HRA	31 March 2021 Principal	Rate/ Return	31 March 2022 Principal	Rate/ Return
Total debt	279	*4.60%*	278	*4.59%*
CFR	346		346	
Over / (under) borrowing	(67)		(68)	
Total investments	0	*n/a*	0	*n/a*
Net debt	279		278	

Annex 2: Prudential and Treasury Indicators

During 2021/22, the Council complied with its legislative and regulatory requirements including the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Debt remained below the operational limit (the level not expected to be exceeded) and the Authorised Limit (the limit which cannot be exceeded without cabinet approval) throughout the year. The CFR was £141m below the Authorised limit and gross debt £472m below.

Actual prudential and treasury indicators	**2020/21 Actual £0**	**2021/22 Actual £0**	**2022/23 Estimate (TMS) £0**
Capital expenditure:			
General Fund	*84,990*	*100,270*	132,100
HRA	*37,652*	*50,764*	170,600
Total	*122,642*	*151,034*	302,700
Capital Financing Requirement:			
General Fund	1,204,089	1,225,943	1,288,900
HRA	345,867	345,867	456,300
Total	1,549,956	1,571,810	1,745,200
Gross debt	1,218,151	1,239,195	1,340,500
Net External debt (gross debt less investments)	953,550	851,981	1,269,700
Investments			
Longer than 1 year	0	0	Nil
Under 1 year	264,601	387,214	70,800
Total	264,601	387,214	70,800
Operational Limit	1,650,000	1,785,000	
Authorised Limit	1,690,000	1,690,000	

The Council’s net external debt (loans plus PFI balances less investments) has decreased by £102m, whilst our overall need for borrowing, which is represented by the CFR, has increased by £21m. This is due to a temporary large increase in investment balances

Movements in Net Debt	2021/22 Movement £000
New Borrowing	50,000
Repaid Borrowing	-9,326
Less PFI Repayments	-19,631
Less increase in Investment	-122,613
Total	-101,569

The CFR increases when we use borrowing to fund capital projects, whilst external debt goes up when we take on new loans or other credit arrangements such as PFI liabilities.

Net Debt has decreased, the table above shows the significance of the increased investment balances on the movement.

These deposits were placed with an array of AAA rated, instant access money market funds, fixed term and call account deposits with banks and investments with other Local Authorities. This investment policy meant that we sought to minimise security risks and increase the liquidity of our deposits. Deposit returns were relatively low at 0.13% (albeit above the UK Bank Base Rate of 0.10% during most 2021/22).

External debt payments haven't changed dramatically in year.

Financing Cost to Revenue looks significantly better but is a result of increases to revenue that are expected to be temporary and the unwinding of one-off higher costs in the previous year.

Financing Costs as a proportion of Revenue

Ratio of financing costs to net revenue stream:	Outturn 2020/21 Act £'000	Outturn 2021/22 £'000
Non-HRA Including PFI	15.5%	14.4%
Non-HRA Excluding PFI	7.5%	6.5%
HRA	8.5%	8.4%

The information in the above takes account of the actual costs associated with external loans plus accounting adjustments for items such as MRP and premiums and discounts adjustment. While the Non HRA ratios have changed significantly, the actual cost of servicing external loans has changed very little this year as new loans were taken in March, so the full year effect of the costs is not reflected.
The reduction in the ratio is as a result of increase to revenue funding mainly in the form covid and recovery grants.

There has been no significant shift in the HRA ratio.

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