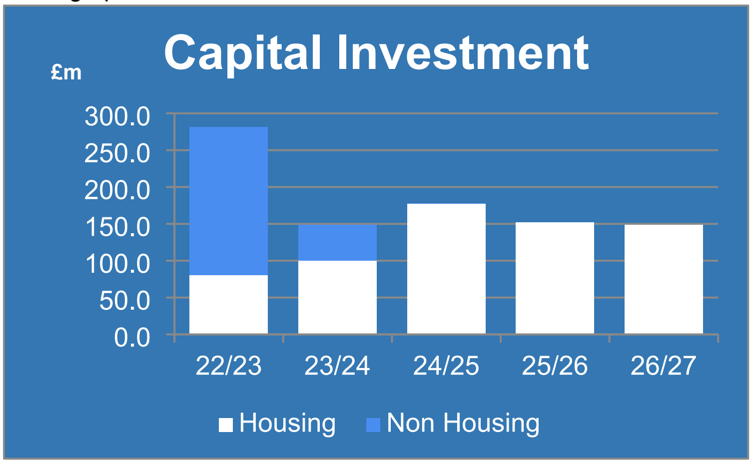
Revenue Implications of Treasury Management as at 30th September 2022

Purpose of the Report

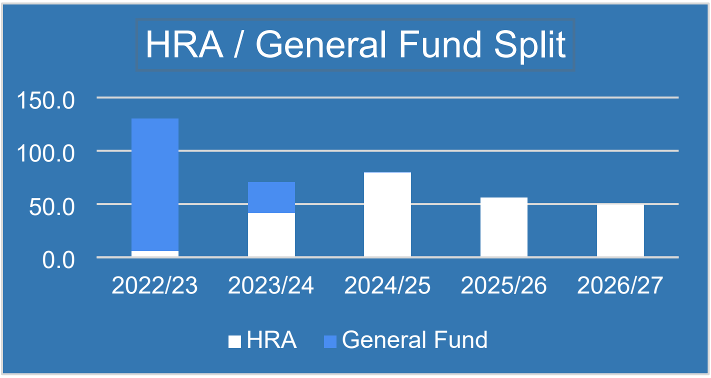
The purpose of this report is to summarise the Treasury Management position for the period to 30th September 2022 and the potential implications for revenue budgets.

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 22/23 to 26/27 totals £909m**	As of 31st August 2022, the approved capital budget, for the period from 2022/23 through to 2026/27 totals £909m (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% of capital expenditure**	The proportion of this investment funded by prudential borrowing over this period will be £387m. On this basis, approximately 42% 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 in 2022/23. In later years 100% of new borrowing will be HRA related.
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 (£153m) makes up most of the borrowing in

the near term, but the HRA forecasts to borrow more from 2023/24 onwards.

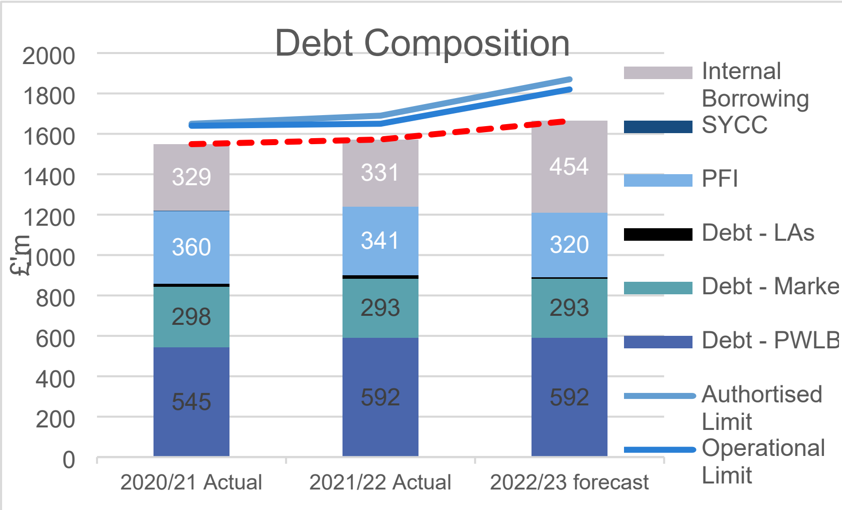


1.6	**The sale of parts of HoTC II programme are expected to be delayed, so borrowing costs and MRP will continue at current levels during this period**	Anticipated disposals of blocks in the Heart of the City development are now expected to be delayed until more favourable economic conditions help maximise 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	**No new external borrowing planned in 22/23. Borrowing rates are currently high and volatile. Internal resources can delay borrowing until more favourable conditions return.**	Economics conditions have seen the cost of borrowing rise dramatically in the 2nd quarter of this year, forecasts are for more uncertainty but with cost eventually falling back by 24/25. This supports delaying borrowing and using internal sources, with options to look at short term borrowing should liquidity become an issue over this period. If 2022/23 forecasts for Prudential borrowing externalised current interest rates of around 5.6% would see an additional (full year cost) of around £7m.
1.8	**Capital Expenditure funded by new borrowing is forecast to be £43.8m lower than Budgeted.**	The latest projected capital expenditure estimates for 2022/23 compared to the original budget position shows that Prudential Borrowing in 2022/23 is projected to Decrease to £130.3m from £174.1m. Within this, HRA borrowing is down by £76m with General fund showing an increase of £32.2m.
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 into next year. Irregular funding flows from government partially created this opportunity. Balances are expected to decrease but have remained level during the first half of the year.

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.



The above table shows:

- The Council is using a substantial proportion of its own liquidity to fund capital expenditure, rather than taking external borrowing. If no further borrowing is externalised the Council will have borrowed internally up to £454m by 31 March 2023.
- 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 2022.
- 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 £50m 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 2022/23 Treasury Management Strategy Statement (TMSS) set out plans to borrow an additional £180m 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 significant interest costs avoided for 2022/23.

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 2022/23
- £8m of loans will be repaid during 2022/23
- No 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 during 2023/24 depending on the levels of capital expenditure.

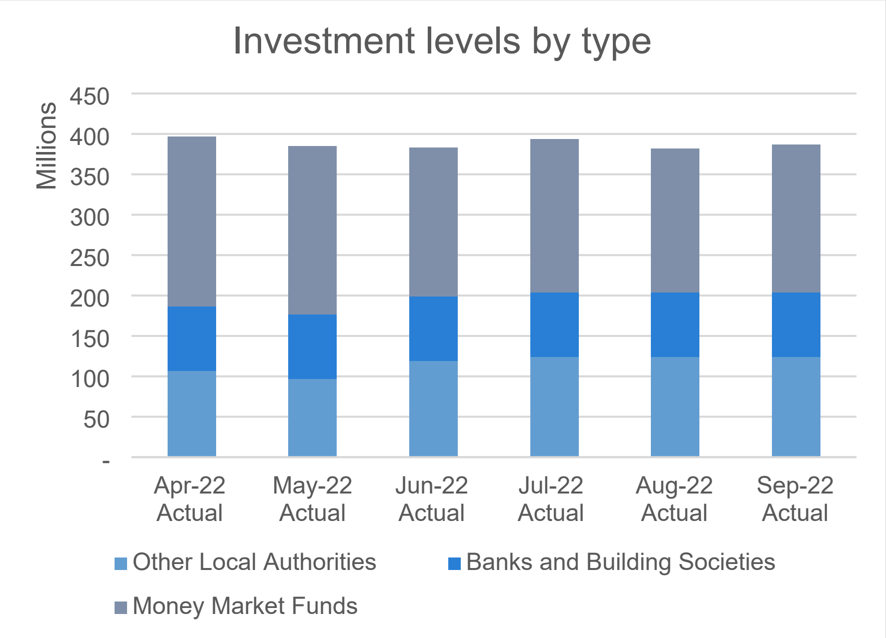
2.3 **No rescheduling of our borrowing has been undertaken**

No rescheduling of any of our borrowing has been undertaken. Options to repay an £18m LOBO loan with Commerzbank are currently being reviewed. This debt is allocated to the HRA so will have no General fund impact. We will keep this position under review, currently the charges to reschedule PWLB debt are higher than the benefits of doing so.

3. Update on Investments

3.1 **Investment balances have decreased by £10m but rates are increasing, this is expected to continue until inflation in the economy is brought under control or bank rates have to ease over recession fears.**

	Mth End Balance (£M)	Average Return
April	£396.8	0.53%
May	£385.1	0.72%
June	£383.0	0.95%
July	£393.7	1.04%
August	£382.2	1.27%
September	£386.9	1.53%
YTD Ave	£388.0	1.00%



Investment balances have remained similar proportionally. However, the second half of the year will see more lending to Locals and Banks as the benefit to yield over liquidity has increased dramatically in

	the higher rate environment.	
3.2	**Sufficient liquidity is being maintained, balances are expected to reduce, but income from investments is higher than budgeted.** **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. However, we are beginning to see more Locals looking for cash, with higher alternative borrowing costs, lending rates to locals have increase dramatically. Bank and other investments are showing similar signs of recovery as the BOE increase base rates. Borrowing costs have also increased and as usual are higher than typical investment returns within our appetite for risk. Investment balances are expected to fall toward the end of the financial year, though income will still be higher than budgeted. 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 or the liquidity requirement of the Authority. There are currently no proposals for the Council to invest sums for periods longer than 365 days.

4. Revenue

4.1 **Treasury Management costs are largely in line with budget. No new borrowing has been done in 22/23**

As at September 2022	Forecast £m	Budget £m	Variance £m
Interest Costs (net of HRA recharge)	21.2	21.4	(0.2)
MRP Costs	17.4	17.4	0
Budget Variances	**38.6**	**38.8**	**(0.2)**

The above table shows:

- Costs are forecast in line with budget as a result of:
    - Additional cost of borrowing in March 22, after budget was set. This has had a full year impact in 2022/23 and was done on anticipation of interest rates increasing.
    - Anticipated 2022/23 borrowing will now be deferred because of strong cash balances and the borrowing mentioned above.

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

22/23 shows a decrease due to Investment

Ratio of Financing Costs to Net Revenue	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000
Finance Costs	£39,379	£35,785	£41,475	£50,928
Net Revenue	£528,524	£527,394	£554,512	£570,200
Ratio	7.45%	6.79%	7.48%	8.93%

income and delays to borrowing costs.	* *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. However, avoidance of new borrowing and increases to investment income in 2022/23 see the ratio come down this financial year. • Financing Costs in 2024/25 include an extra £8.7m in MRP. £5.7m of this is due to the ending of reversals for pervious overprovisions. • 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 2023/24 to 2024/25 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 considering 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 2021/22 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 2022/23

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	2022/23 Forecast £m	2022/23 Budget £m	2022/23 Variance £m
Non-Housing Expenditure	200.9	132.1	68.8
Housing Expenditure	80.6	170.6	-90.0
Total	**281.5**	**302.7**	**-21.2**
Financed by:			
Capital Receipts	21.3	32.5	-11.2
Capital Grants and Contributions	91.1	43.0	48.1
Revenue Contributions	38.8	53.1	-14.3
Prudential Borrowing	130.3	174.1	-43.9
Total	**281.5**	**302.7**	**-21.2**

Breakdown of Capital Expenditure

Capital Expenditure	22/23	23/24	24/25	25/26	26/27
ADULT HEALTH & SOCIAL CARE	0.9	0.0	0.0	0.0	0.0
COMMUNITIES, PARKS & LEISURE	8.4	0.0	0.0	0.0	0.0
ECONOMIC DEVELOPMENT & SKILLS	80.6	100.0	177.6	0.0	0.0
EDUCATION, CHILDREN & FAMILIES	133.7	23.0	0.0	0.0	0.0
HOUSING	6.8	0.0	0.0	152.5	149.0
STRATEGY & RESOURCES	25.3	18.6	0.0	0.0	0.0
TRANSPORT, REGEN & CLIMATE	25.1	6.8	0.0	0.0	0.0
WASTE & STREET SCENE	0.7	0.0	0.0	0.0	0.0
TOTAL	**281.5**	**148.4**	**177.6**	**152.5**	**149.0**

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	Per TMSS 22/23	Mid-Year Forecast £m
CFR - General Fund CFR	1,288.9	1,312.0
CFR - Housing Revenue Account	456.3	352.0
TOTAL	1,745.2	1,664.0
Borrowing	1020.0	890.2
Other Long-Term Liabilities	320.0	320.0
Forecast - Total Debt as of 31 March 2023	**1340.0**	**1210.2**

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	1,745	1,664
Headroom to Operational Boundary (CFR)	5	86
Headroom to Authorised Borrowing Limit (CFR)	35	116
Projected External Debt at 31 March 2022	1,340	1,210
Headroom to Operational Boundary (debt)	410	540
Headroom to Authorised Borrowing Limit (Debt)	440	570

Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, has provided the following forecast. The dramatic increase in the bank rate between their two forecasts is indicative of the level of volatility. This dramatic change was caused by the Governments Mini budget and their inflationary nature of their policy.

Updating of our forecasts 27 September 2022

Comparison of forecasts for Bank Rate today v. previous forecast

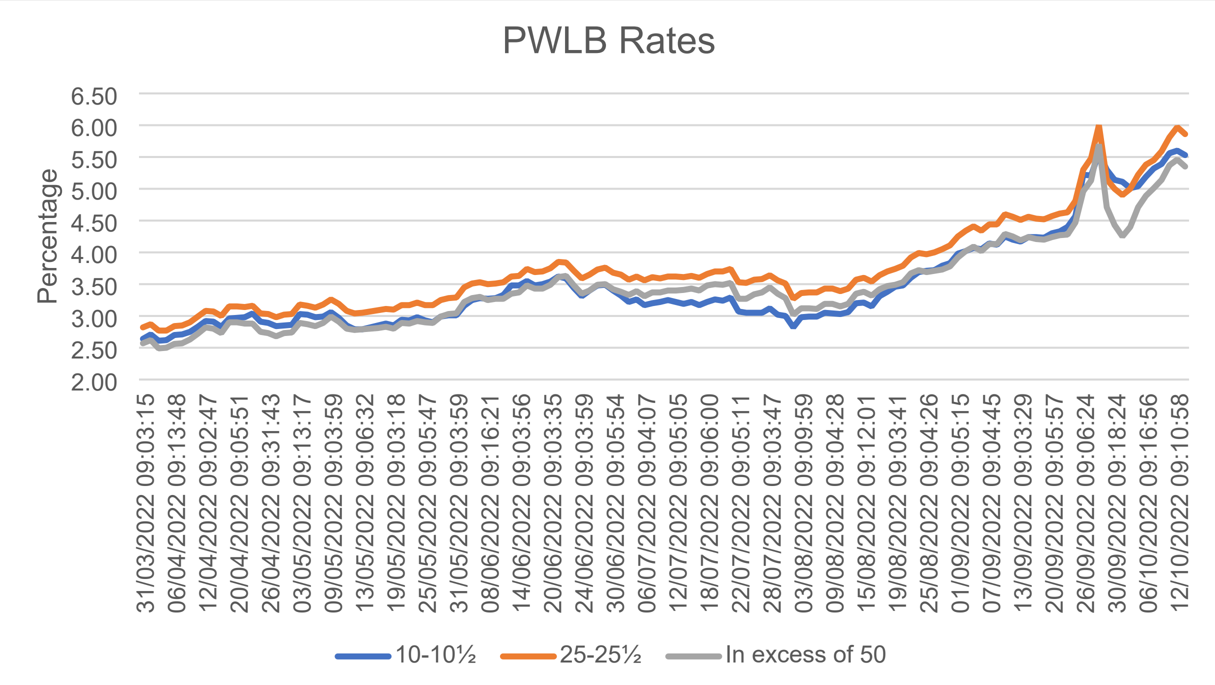
Bank Rate	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
27.09.22	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
09.08.22	2.50	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	2.25	2.00
Change	1.50	2.25	2.25	2.25	2.00	1.50	1.50	1.00	0.75	0.50	0.50	0.50

The long term forecast for for borrowing rates is to reduce steadily from 23 onwards. However, PWLB 25 year has already touched 6% in early October before falling back considerably. There remains significant uncertainty in gilt markets, strong cash balances should allow us to delay new borrowing until coditions are more favourable.

Link Group Interest Rate View	27.09.22											
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
BANK RATE	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

PWLB

Up to August 22 PWLB rates were fairly static, the problem of inflation and energy costs became a huge problem, and the bank of England were forced to increase the base rate. The general situation is for volatility in bond yields to endure as investor fears for inflation and/or recession ebb and flow.



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