Sheffield City Council

Treasury Management Outturn Report 2022/23

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Key Messages

All investment and borrowing transactions were in line with the principles approved in the 2022-23 Annual Treasury Strategy Statement and the Annual Ethical Investment Strategy.

No new long term borrowing has been taken in year.

During 2022/23 Bank of England Base Rates increased from 0.75% to 4.25%. Inflation peaked at 14.1% (RPI Oct 22) and remains historically high.

Director of Finance and Commercial Services' Overview

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 2022/23. 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 2022/23, the Full Council received the annual Treasury Management Strategy Statement (TMSS), whilst Co-Operative Executive was presented with the 2021/22 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.

Training was provided for Members in year in collaboration with Link treasury services and Treasury Officers.

The Strategy for 2022/23

The Strategy was set for 2022/23 in Nov / Dec 21, prior to the start of the Russia – Ukraine war. Expectations were for the bank rate to reach 0.75% by the end of 2022/23 however, exceptionally high inflation saw the Bank of England (BOE) forced to raise interest rates . Energy price inflation was becoming a problem before the war as the world went back to 'normal' after the Covid Pandemic. The conflict in Ukraine saw inflation hit food prices and now wage growth, partially driven by labour shortages could see inflation becoming a systemic problem.

Investment earnings jumped dramatically during the year. The Strategy forecast an average return of 0.3% the actual being 1.85% but also with higher than expected cash balances. This generated a significant underspend on the Treasury budget. The effect of this has been accounted for in 23/24 already but is expected to reduce as cash balances and interest rates both normalise.

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. 2022/23 saw PWLB borrowing rates increase steadily to around 4.5%, well above the forecasts in the Treasury Strategy (2%). Medium forecasts are for rates to come down, so the borrowing strategy changed to using cash balances or short dated Local Authority loans until borrowing rates improve. High cash balances also supported this decision to delay borrowing.

The Council operated within the Prudential Indicator Limits for 2022/23 set by the authority.

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 22/23 despite a budget of £82m

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

Only £10m of new borrowing was taken in year, this was short term and taken to cover potential liquidity risk at year end.

Investment balances decreased slightly but provided a significant increase over budgeted returns due to increasing interest rates.

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 2021/22 and 2022/23, and the original forecast for 2022/23 including PFI liabilities.

	2021/22 Actual (£m)	2022/23 Actual (£m)	2022/23 Budget From TMS (£m)
General Fund CFR (non PFI)	885	926	969
General Fund - PFI Liabilities	341	320	320
Overall General Fund CFR	1,226	1,246	1,289
HRA CFR	346	346	456
Total CFR	1,572	1,592	1,745

After adjusting for PFI liabilities of £321m, the overall underlying financing requirement of the Authority is £1,246m (an increase of 1.6% on the 2021/22 figure). This is lower than the 5.1% increase forecast in the budget.

Actual capital investment for 2022-23 was £190.6m, this is lower than the planned £302.7m set out in the TMSS. Capital Expenditure financed by borrowing was £59.0m, £115m lower than anticipated at the start of the year, £82m of this related to HRA expenditure that was not financed by borrowing as initially planned.

Gross external debt, excluding PFI liabilities, has increased by £2m to £900m compared to 2021/22. This is a short term £10m new loans whist £8m of existing loans matured.

Investment balances decreased by £24m to close the year at £363m. Despite lower balances, higher rates meant the Treasury budget earnt £6.5m more in investment income than forecast.

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 it's impact on food and fuel prices.

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

UK. Economy. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	4.25%	3%	4.75%-5%
GDP	0.1%q/q Q4 (4.1%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.6% Q4 Annualised
Inflation	10.4%y/y (Feb)	6.9%y/y (Mar)	6.0%y/y (Feb)
Unemployment Rate	3.7% (Jan)	6.6% (Feb)	3.6% (Feb)

CPI inflation picked up to what should be a peak reading of 11.1% in October, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply-side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4% by the end of 2023. As of February 2023, CPI was 10.4%.

The UK unemployment rate fell through 2022 to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact remains, however, that with many economic participants registered as long-term sick, the UK labour force shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Bank Rate increased steadily throughout 2022/23, starting at 0.75% and finishing at 4.25%.

USA. The flurry of comments from Fed officials over recent months suggest there is still an underlying hawkish theme to their outlook for interest rates. Markets are pricing in a further interest rate increases of 25-50bps, on top of the current interest rate range of 4.75% - 5%.

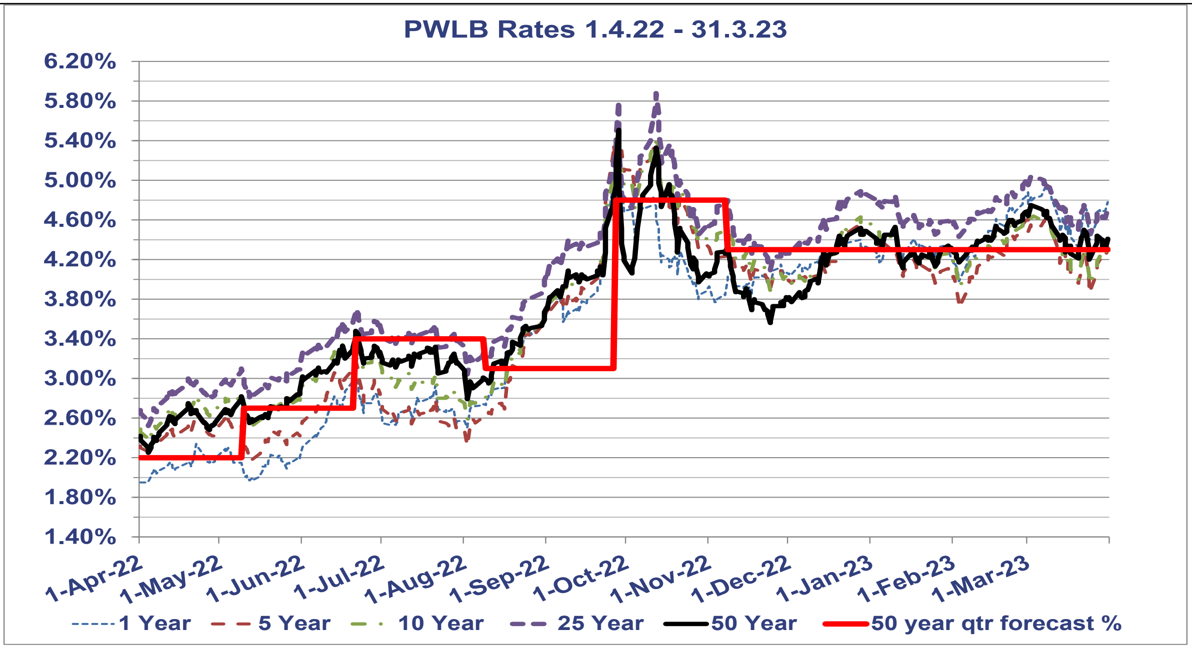
In addition, the Fed is expected to continue to run down its balance sheet once the on-going concerns about some elements of niche banking provision are in the rear-view mirror.

As for inflation, it is currently at c6% but with the economy expected to weaken during 2023, and wage data already falling back, there is the prospect that should the economy slide into a recession of any kind there will be scope for rates to be cut at the backend of 2023 or shortly after.

EU. Although the Euro-zone inflation rate has fallen below 7%, the ECB will still be mindful that it has further work to do to dampen inflation expectations and it seems destined to raise rates to 4% in order to do so. Like the UK, growth has remained more robust than anticipated but a recession in 2023 is still seen as likely by most commentators.

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.

Key Messages:	Borrowing and Investment Rates
Investment rates rose during 2022/23 and may be near their peak. The PWLB remains 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.	Investment returns rose rapidly in 22/23 as the BOE began to increase the Base Rate. Local local authorities were faced with the challenge of pro-active investment of surplus cash for the first time in over a decade, and this emphasised the need for a detailed working knowledge of cashflow projections so that the appropriate balance between maintaining cash for liquidity purposes, and "laddering" deposits on a rolling basis to lock in the increase in investment rates as duration was extended, became an on-going feature of the investment landscape. Meantime, through the autumn, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress. 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 2022/23 and the two subsequent financial years. Rising Inflation lead to the BOW increasing base rate and therefore the corresponding increase to borrowing rates below. when inflation concerns increased significantly. Internal, variable, or short-term rates, are expected to be the cheaper form of borrowing until well in to the second half of 2023/24.



PWLB Rates 1.4.22 - 31.3.23
6.20%
5.80%
5.40%
5.00%
4.60%
4.20%
3.80%
3.40%
3.00%
2.60%
2.20%
1.80%
1.40%
1-Apr-22
1-May-22
1-Jun-22
1-Jul-22
1-Aug-22
1-Sep-22
1-Oct-22
1-Nov-22
1-Dec-22
1-Jan-23
1-Feb-23
1-Mar-23
1 Year
5 Year
10 Year
25 Year
50 Year
50 year qtr forecast %

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Key Messages:	Borrowing Outturn for 2022/23

Key Messages:

The strategy to reduce under-borrowing was postponed this year due to high cash balance and slippage in the capital programme and increases to borrowing costs that are expected to reduce in future years.

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

Borrowing Outturn for 2022/23

The table below shows the breakdown for capital expenditure that should have been financed by external borrowing during the year. No long term external borrowing was required to cover 22/23 capital expenditure. . The result of this is that the Council's under borrowed position has increased by £39m to £371m. 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.
Most of the slippage below (£82m) relates to HRA capital expenditure either delayed or financed by other means.

	£000	£000
Original borrowing Per 22/23 TMS		174,100
Expenditure on Schemes financed By Borrowing:		
Heart of the City	40,753	
Leisure Facilities	16,559	
Other	1,919	
		59,231
Variance to TMS		- 114,869

The 2022/23 TMS aimed to slightly reduce the level of internal borrowing. However, during the year investment balances have remained high and new borrowing would have added to this. The strength of the cash position and the increase to borrowing rates that is forecast to be temporary both supported delaying further long term borrowing

Under borrowing remains at sustainable levels, but still carries significant interest rate risk – as interest rates could rise further. 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 so it will be key to see how quickly this can be brought back down to target levels.

Key Messages:

Net borrowing for the year was £2m but new borrowing was very short term.

Details of the borrowing taken and repaid in 2022/23 are shown in the table below:

Loan Repayments and Borrowing 2022/23						
New Borrowing				Loans Repaid		
Counterparty	Amount (£000)	term	Interest Rate (%)	Counterparty	Amount (£000)	Original Rate (%)
SYMCA	£10,000	1 month	4.00%	SYMCA	£8,000	2.45%
	10,000				**8,000**	
Net borrowing	**2,000**					

Borrowing rates are returning to historical averages. New borrowing was taken at rate of 4.0% but this was only taken for one month over year end to cover potential liquidity issues. The monies were deposited in MMF and net cost was therefore negligible.

As at 31 March 2023, the loans portfolio, excluding PFI liabilities, totalled £900m, and indicates the Council is under borrowed by £371m – an increase of £39m on the previous year.

Key Messages:	Debt Rescheduling
There has been no debt rescheduled during 2022/23	No rescheduling was done during the year as differential between PWLB new borrowing and premature repayment rates made rescheduling unviable. We have considered several of the Authorities LOBOS during 2022/23 but repayment premiums were too high to justify repayment.
	Investment Outturn
	<u>Ethical Investment Policy</u>
Investment balances held by the Council were expected to decrease during the year – this was the case but not as much as first thought.	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.
Investment balances Decreased by £24m compared to 31 March 2021	The investment activity during the year conformed to the approved Investment Strategy. <u>Investments held by the Council</u>
Investment returns have increased much more than was expected because of geopolitical reasons.	The Council maintained an average balance of £405m of internally managed funds. As at 31st March 2022, investments were £363m; down £24m on the previous year. The Council had no liquidity difficulties during the year. The internally managed funds earned an average rate of return of 1.85% compared to 0.13% in the previous year. This should still be judged a good achievement given the state of the market, the base rate was just 0.75 at the start of the year and some fixed rates investments were locked in at lower rates. 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.

Annex 1: Outturn Position with General Fund & HRA Split

Authority	31 March 2022 Principal	Rate/ Return	31 March 2023 Principal	Rate/ Return
Total debt	898	*3.90%*	900	*3.81%*
CFR	1231		1272	
Over / (under) borrowing	-333		-371	
Total investments	387	*0.11%*	363	*1.85%*
Net debt	511		537	

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	

General Fund	**31 March 2022 Principal**	**Rate/ Return**	**31 March 2023 Principal**	**Rate/ Return**
Total debt	620	*3.45%*	622	*3.46%*
CFR (exc PFI)	885		926	
Over / (under) borrowing	-265		-304	
Total investments	387	*0.11%*	363	*1.85%*
Net debt	233		259	

HRA	**31 March 2022 Principal**	**Rate/ Return**	**31 March 2023 Principal**	**Rate/ Return**
Total debt	279	*4.59%*	278	*4.59%*
CFR	346		346	
Over / (under) borrowing	-67		-68	
Total investments	0	*n/a*	0	*n/a*
Net debt	279		278	

The Council's net external debt (loans plus PFI balances less investments) has increased by £5m, whilst our overall need for borrowing, which is represented by the CFR, has increased by £41m. This is due to a temporary large increase in investment balances.

Movements in Net Debt	2022/23 Movement £000
New Borrowing	10,000
Repaid Borrowing	-8,000
Less PFI Repayments	-20,656
Add decrease in Investment	24,089
Total	5,433

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 increased, PFI repayments and the decrease in investment balances are the main factors in this Increase.

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 have averaged 1.85% over the year but increasing bank rates mean by year end new deposit at over 4% were not an unreasonable expectation.

External debt payments haven't changed dramatically in year.

Financing Cost to Revenue looks significantly better but is a result of increases in investment income the net revenue position.

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Financing Costs as a proportion of Revenue

	Outturn	
	2021/22	**22/23**
Ratio of financing costs to net revenue stream:	**£'000**	**£'000**
Non-HRA Including PFI)	16.0%	14.6%
Non-HRA Excluding PFI)	7.3%	6.1%
HRA	8.4%	7.9%

The information in the above table takes account of the actual costs associated with external loans plus accounting adjustments for items such as MRP and premiums and discounts adjustment. While all ratios have improved the actual cost of servicing the Authorities loans has changed very little in year. There were small increases to revenue but the most material impact was for Investment income which nets of the overall cost.

MRP costs are forecast to increase in 2023/24 and this ratio will increase.

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