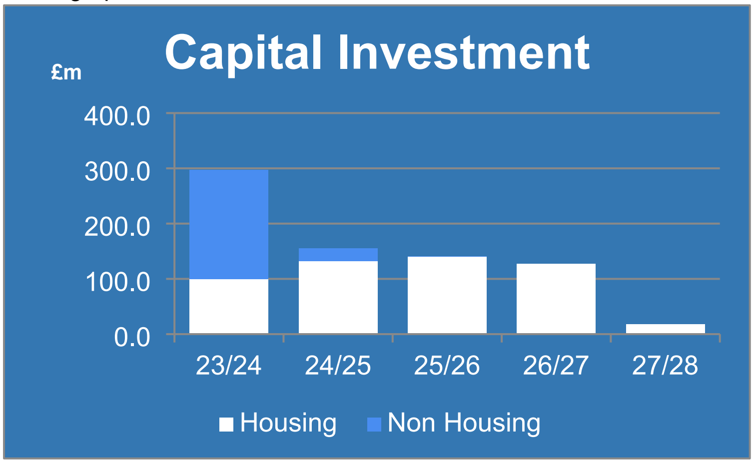
Revenue Implications of Treasury

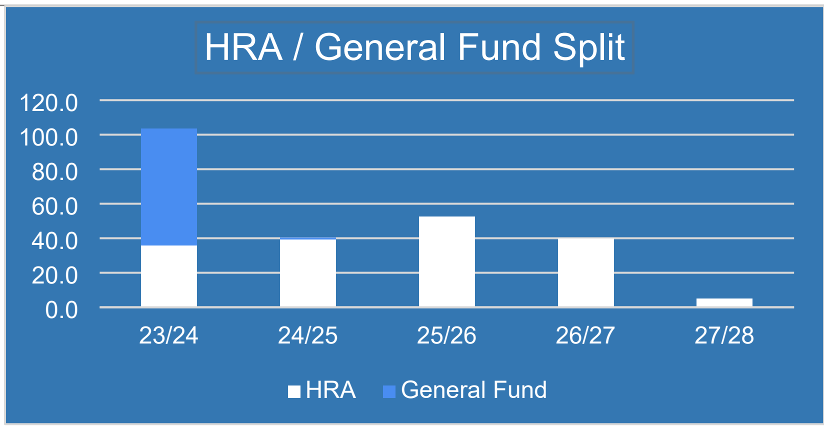
Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 30th September 2023 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 23/24 to 27/28 totals £736m**	As at 31st August 2023, the approved capital budget, for the period from 2023/24 through to 2027/28 totals £736m (a full breakdown is shown in Appendix A). Budget for this period was just £605m, indicating material slippage in the programme to the end of 22/23.
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	**33% of capital expenditure will be financed by borrowing up to the end of 27/28**	The proportion of this investment funded by prudential borrowing over this period will be £241m. On this basis, approximately 33% of the capital expenditure planned for the next four years is being funded by Prudential Borrowing. After 2023/24 almost all borrowing will be related to HRA expenditure.
1.5	**Graph - Prudential borrowing over next 5 years**	The following graph shows how this element of funding varies over the five years. HRA borrowing (£153.7m) makes up the majority of borrowing over the period term, with the General Fund requirement much lower after completion of HOTC works in the near term.



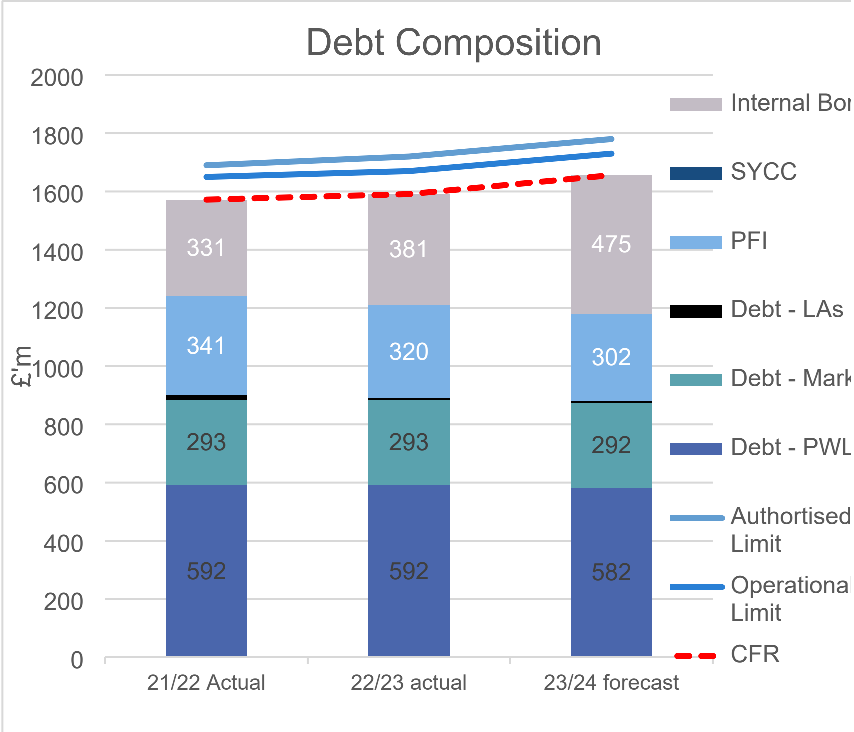
1.6	**Disposal of HoTC II assets are expected to be delayed. Borrowing costs and MRP will continue at current levels during this period**	Anticipated disposals of Blocks in the Heart of the City development are now expected to be delayed until more favourable economic conditions help maximise the benefit 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.
1.7	**No new external borrowing planned in 23/24. 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 first half 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 100% of 23/24 forecasts for Prudential borrowing was externalised at current interest rates of around 5.5%, this would see an additional (fully year cost) of around £5.6m.
1.8	**Capital Expenditure funded by new borrowing is forecast to be £13m higher than budgeted.**	The latest projected capital expenditure estimates for 2023/24 compared to the original budget position shows that Prudential Borrowing is £13m higher than budgeted. Within this HRA borrowing is down by £18m as expenditure is financed by other means. General fund shows an increase of £30m due to slippage from previous years and rising.
1.9	**Cash balances have remined strong and so we have delayed external borrowing.**	Cash balances have remained strong and have afforded us the luxury of delaying borrowing into next year. Irregular funding flows from government partially creates this opportunity but other sources such as working capital balances also contribute. 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.

Rates expected to fall but will remain higher for longer than in previous forecasts.



The above table shows:-

- The capital financing requirement continues to increase as the council is using new borrowing to finance capital schemes at a faster rate than it is being reduced by provisions to repay debt (MRP).
- 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 £475m by 31st March 2024.
- This approach is taken because we pay more to borrow externally than we receive on any cash we invest. This report assumes further internal borrowing, as interest rates are expected to fall in the medium term. However, the scale of internal borrowing makes the associated interest rate risk, i.e. rates could be higher in future when we need to borrow externally a material consideration.
- Budgeted borrowing costs are expected to be avoided. Forecast was for small amounts to be taken from Sept 23 onwards. Avoiding this is expected to save in the region on £500k, no new borrowing has been taken since March 22.
- 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.

2.2 Strategy Update – no proposed changes except delays to proposed borrowing.

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 2023/24 Treasury Management Strategy Statement (TMSS) set out plans to borrow an additional £80m 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 2023/24.

So far this financial year:-

- £10m of loans will be repaid during 23/24
- 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 its capital investment programme which will lead to new borrowing being required. This borrowing is expected to be needed during 24/25 at the earliest, 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.

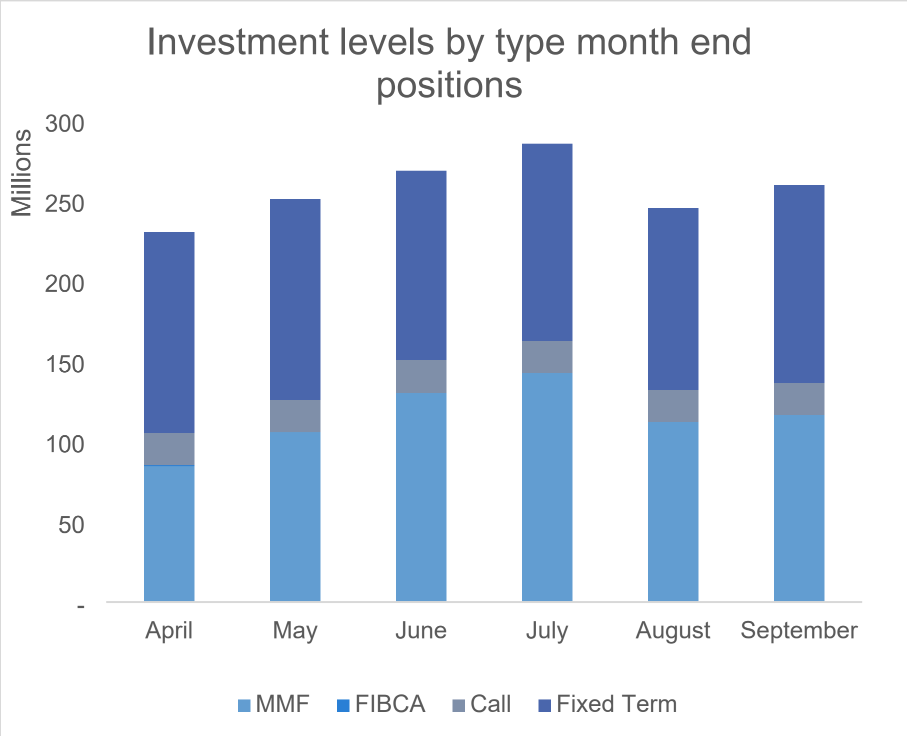
2.4

23/24 Investment Balances	23/24 Monthly Average Balances (£M)	23/24 Average Return		22/23 Average Return
April	£297.6	3.85%		0.5%
May	£277.9	3.91%		0.7%
June	£278.1	4.00%		1.0%
July	£282.5	4.20%		1.0%
August	£283.5	4.40%		1.3%
September	£282.2	4.50%		1.5%
YTD Ave	£283.6	4.14%		

Investment balances have remained consistently higher than anticipated throughout the first half of the year. Rates of return have also exceeded forecasts of around 4%, contributing to an increase in income of around £4.5m. Rates are significantly higher than 12 month ago, but expectations are that we are now at or near the peak. Average returns will continue to increase in the later half of the year as older (lower returning) investments mature.

3. Update on Investments

3.1 **Investment balances have decreased by £103m from March 23 due to £140m of pension prepayments in April 23. Excluding the pension prepayment balances have increased so far this year.**



Investment balances appear to have increase marginally throughout the year with only moderate movements month to month. While these tables are representative of the normal patterns for investment balances, they do not show a large decrease from the opening balance of £363m. The decrease from this opening position was due to significant pension prepayments made in April 23.

3.2 **Sufficient liquidity is being maintained, balances are expected to reduce, but income from investments is higher than budgeted.**

Liquidity in the Local Authority sector is diminishing, competition for borrowing is increasing and this demand is increasing the rates paid for Local to Local lending. In the short term, while balances allow, Sheffield can take advantage of lending at these rates. Bank and other investments had shown showing similar signs of recovery as the BOE increased base rates but this appears to have peaked based on expectations that future movements of base rate will be downwards. Borrowing costs have increased during the quarter 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.

There are no investments for longer than 365 days

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 budget is underspent as a result of increased income. This should be considered a short term bonus.**

As at September 2023	Forecast £m	Budget £m	Variance £m
Investment Income	- 10.5	- 3.9	- 6.6
Interest Costs (net of HRA recharge)	18.3	16.8	1.5
MRP Costs	15.0	15.1	- 0.1
Budget Variances	**22.8**	**28**	**-5.2**

The above table shows:

- Costs are forecast in line with budget as a result of:
    - Interest Income is the main reason for the budget underspend. It's important to note cannot be relied on to supplement services other than in the short term. Reserves and Working capital balances will be depleted and rates of return will fall in future years.
    - Interest costs are showing over as a result of amendments to the budget position and lower than budgeted transfer of cost to the HRA.
    - In the medium term costs are expected to rise as accounting adjustments made to MRP expire in 24/25 and the significant underborrowed position and risk are unwound.

4.2 **Financing Costs as a proportion of Net Revenue are expected to increase.**

Mainly due to decreasing income (netted off cost) and increase in MRP as corrections to overprovision ends.

Ratio of Financing Costs To Net Revenue	2023/24	2024/25	2025/26
Finance Costs (net)	£31,739	£41,211	£46,190
Net Revenue	£500,763	£518,521	£532,506
Ratio	6.34%	7.95%	8.67%

** 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, over this period external interest costs are only expected to increase marginally from £21.1m to £23.8m.
- Financing Costs in 24/25 include an extra £7.8m in MRP. £5.7m of this is due to the ending of reversals for pervious overprovisions.
- Investment income is netted of the financing cost above, this is expected to be less in future years falling from around £11m in 23/24 to £5m in 25/26 as both balances and rates decline.
- Please note that the capital programme projections become less accurate the further forward the forecast, and therefore financing costs may increase if the amount of the capital programme 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 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 2023/24.

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 2023	2023/24 Forecast £m	2023/24 Budget £m	2023/24 Variance £m
Non Housing Expenditure	197.6	107.2	90.4
Housing Expenditure	99.2	106.9	-7.8
Total	**296.8**	**214.1**	**82.7**
Financed by:			
Capital Receipts	18.4	8.2	10.2
Capital Grants and Contributions	135.1	57.8	77.3
Revenue Contributions	39.8	57.3	-17.5
Prudential Borrowing	103.5	90.8	12.7
Total	**296.8**	**214.1**	**82.7**

Breakdown of Capital Expenditure

Capital Expenditure	**23/24**	**24/25**	**25/26**	**26/27**	**27/28**
ADULT HEALTH & SOCIAL CARE	6.2	0.0	0.0	0.0	0.0
COMMUNITIES, PARKS & LEISURE	25.3	0.1	0.0	0.0	0.0
ECONOMIC DEVELOPMENT & SKILLS	1.1	0.3	0.0	0.0	0.0
EDUCATION, CHILDREN & FAMILIES	22.0	3.4	0.0	0.0	0.0
HOUSING	99.2	132.0	140.4	126.8	17.2
STRATEGY & RESOURCES	6.0	0.0	0.0	0.0	0.0
TRANSPORT, REGEN & CLIMATE	136.1	19.2	0.7	0.0	0.0
WASTE & STREET SCENE	0.9	0.0	0.0	0.0	0.0
TOTAL	**296.8**	**155.1**	**141.1**	**126.8**	**17.2**

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	**Per TMSS 23/24**	**Mid Year Forecast £m**
CFR - General Fund CFR	1,282.0	1,293.6
CFR - Housing Revenue Account	399.7	362.6
TOTAL	1,681.7	1,656.2
Borrowing	1020.0	890.2
Other Long Term Liabilities	320.0	320.0
Forecast - Total Debt as at 31 March 2022	**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	1,682	1,656
Headroom to Operational Boundary (CFR)	68	94
Headroom to Authorised Borrowing Limit (CFR)	98	124
Projected External Debt at 31 March 2024	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.

Updating of our forecasts 27 September 2022

Comparison of forecasts for Bank Rate today v. previous forecast

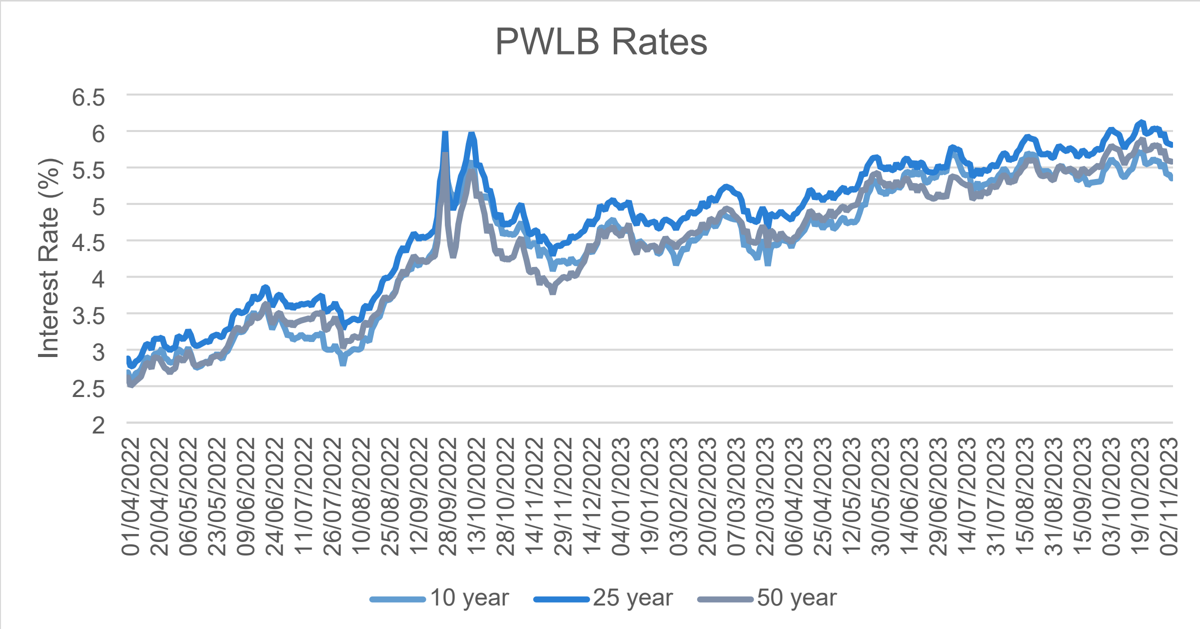
Bank Rate	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
27.09.22	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
09.08.22	2.50	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	2.25	2.00
Change	1.50	2.25	2.25	2.25	2.00	1.50	1.50	1.00	0.75	0.50	0.50	0.50

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

PWLB Rates have risen significantly over the last two years. The increasing UK base rate has typically seen a corresponding increase PWLB borrowing rates. Current rates are higher now than the spike seen in October 22. There are local and global factors that could increase gilts such as the forthcoming UK general election and heightening tensions in the middle east.



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