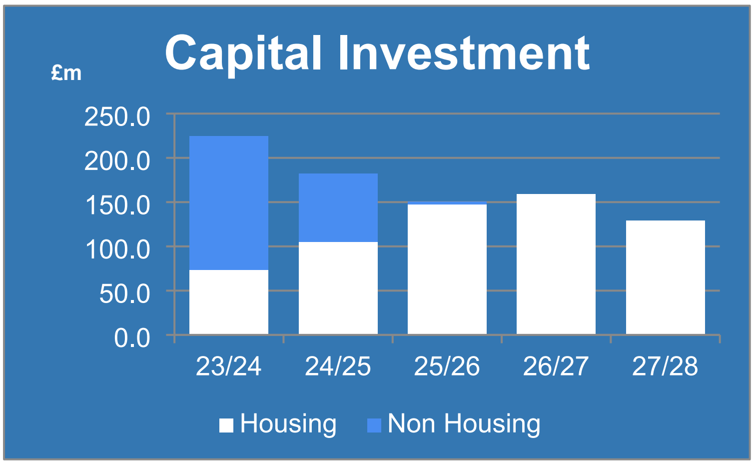
Revenue Implications of Treasury

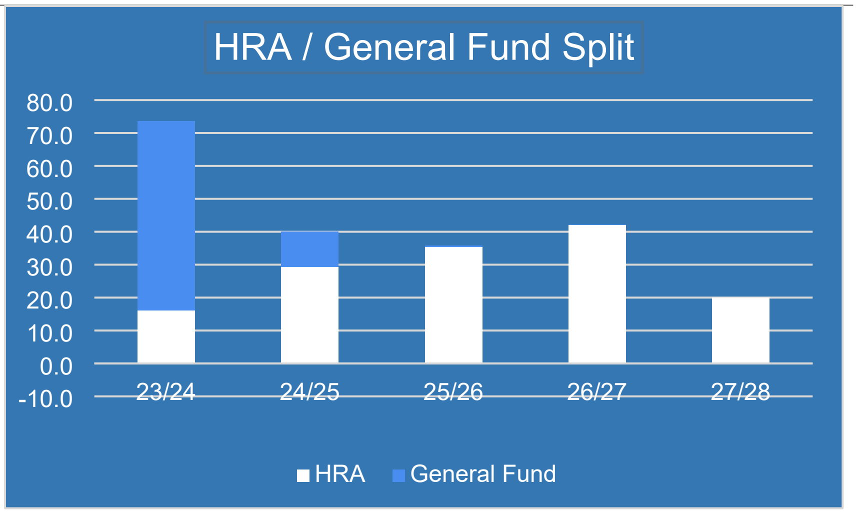
Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 31st December 2023 and the potential implications for revenue budgets.

In addition, Appendix A 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 £845m**	As at 31st December, the approved capital budget, for the period from 2023/24 through to 2027/28 totals £845m (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 and approval of new Capital Expenditure.
1.3	**Housing and non-housing split of planned investment shows most approved capital expenditure is HRA related.**	The split of this planned investment across housing and non-housing is shown in the graph below: - 
1.4	**27% 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 £225m. On this basis, approximately 27% of the capital expenditure planned for the next four years is being funded by Prudential Borrowing, at the budget setting this proportion was 42%. Grants and contributions have increased, reducing the borrowing ratio. 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 (£142.8m) makes up most borrowing over the period, with the General Fund requirement much lower after completion of HOTC works in the near term.



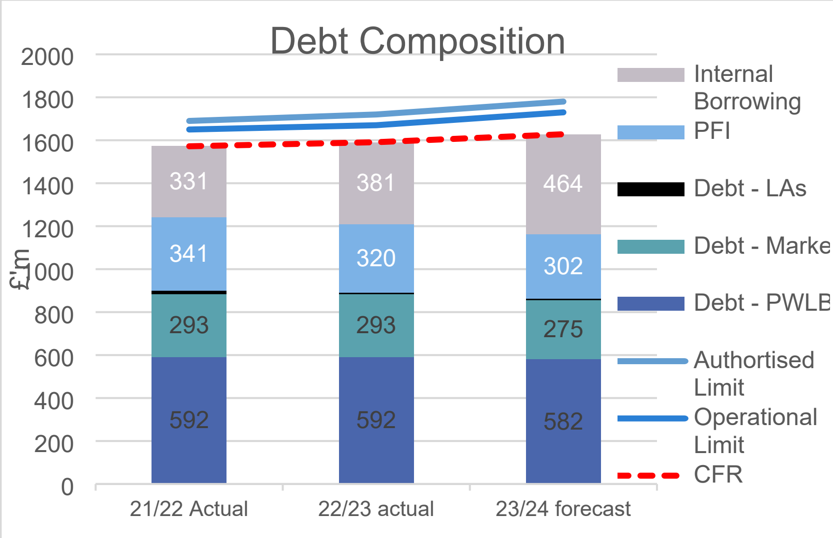
1.6	**Disposal of HoTC II assets is expected to be delayed. Borrowing costs and MRP will continue at current levels during this period**	Anticipated disposals of blocks in the Heart of the City development are now expected to be delayed until more favourable economic conditions help maximise the benefit 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 fall back somewhat in the last quarter in expectation of rate cuts mid 24/25. Rates are still marginally above where they were at the start of the financial year having seen a steady increase for the first half of the year. Expectations are for more uncertainty due to geopolitical instability 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 4.8% (5.5% Sept 23), this would see an additional (fully year cost) of around 3.5m (£5.6m at Sept 23).
1.8	**Capital Expenditure funded by new borrowing is forecast to be £17.2m lower than budgeted.**	The latest projected capital expenditure estimates for 2023/24 compared to the original budget position shows that Prudential Borrowing is £17.2M lower than budgeted. HRA's borrowing requirement is £18.7m lower with General fund increasing by £1.5m.
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 higher than anticipated to December 23. This has contributed to higher than anticipated income.

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.

Market debt has fallen as an £18m Commerzbank loan was repaid. This has not yet been replaced with new debt.



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 £492m 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 in 23/24. The Original budget included small amounts to be taken from Sept 23 onwards. Avoiding this is expected to save in the region on £500k, no new long-term 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 any limits 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: -

- £38m 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 (changing or extending terms) of any of our borrowing has taken place. However, an £18m LOBO loan with Commerzbank was rapid without penalty following their decision to increase the rate on this loan. This debt was allocated to the HRA so has 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.

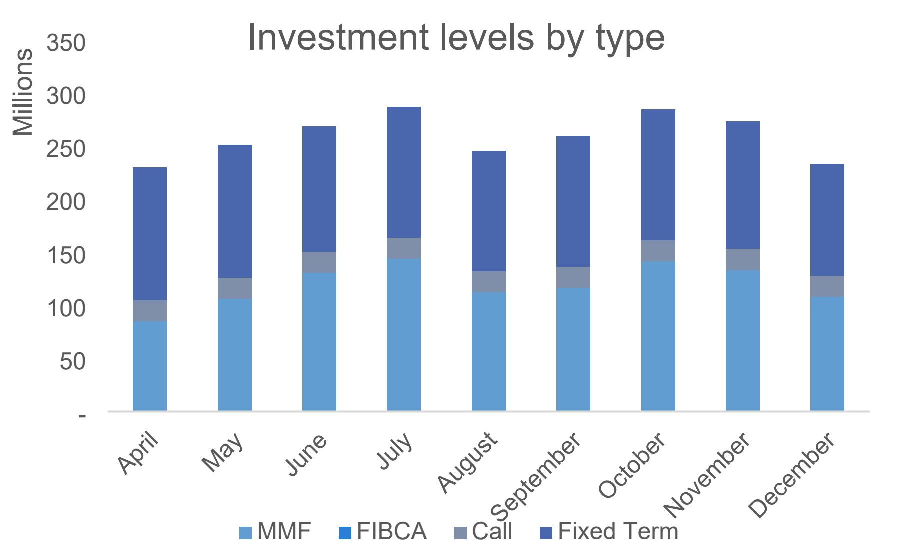
2.4

Investment Balances	23/24 Average balance in month (£M)	23/24 Average Return	22/23 Average Return
April	£297.6	3.85%	0.5%
May	£258.7	3.97%	0.7%
June	£278.6	4.25%	1.0%
July	£295.3	4.75%	1.0%
August	£287.2	5.00%	1.3%
September	£275.6	5.09%	1.5%
October	£291.5	5.17%	1.7%
November	£302.9	5.23%	2.1%
December	£262.7	5.31%	2.6%
YTD Ave	£283.3	4.83%	

Investment balances have remained consistently higher than anticipated to Dec 23. Rates of return have also exceeded that budgeted (4%), contributing to an increase in income of around £5.6m. 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 final quarter 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 remain close to the opening position.**



Despite in year movements investment balances are at the same as April 23 of around £230m, these tables are representative of the normal patterns for investment balances. However, 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, the balance above is a month end position.

3.2 **Sufficient liquidity is being maintained. Balances are expected to reduce in Q4, but income from investments is higher than budgeted.**

There are no investments for longer than 365 days

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.

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 – Material Variances

4.1 **Treasury Management budget is underspent because of increased income. This should be considered a short-term bonus.**

As at December 23	Forecast £m	Budget £m	Variance £m
Investment Income	-8.4	-4.7	-3.7
Interest Costs (net of HRA recharge)	20.9	21.6	-0.7
MRP Costs	13.9	15.1	-1.2
Budget Variances	**26.4**	**32**	**-5.6**

The above table shows:

- Costs are forecast in line with budget because 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.
    - 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	£31,739	£41,211	£46,190
Net Revenue	£535,709	£560,567	£578,614
Ratio	5.92%	7.35%	7.98%

* *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 £7.5m 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 2023/24 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 nine months of 2023/24.

Appendix A – 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 December 2024	2023/24 Forecast £m	2023/24 Budget £m	2023/24 Variance £m
Non-Housing Expenditure	151.0	107.2	43.8
Housing Expenditure	73.4	106.9	-33.6
Total	**224.3**	**214.1**	**10.2**
Financed by:			
Capital Receipts	16.5	8.2	8.3
Capital Grants and Contributions	93.6	57.8	35.8
Revenue Contributions	40.7	57.3	-16.6
Prudential Borrowing	73.6	90.8	-17.2
Total	**224.3**	**214.1**	**10.2**

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	25.9	2.5	0.0	0.0	0.0
ECONOMIC DEVELOPMENT & SKILLS	1.1	1.9	0.0	0.0	0.0
EDUCATION, CHILDREN & FAMILIES	22.5	4.5	0.0	0.0	0.0
HOUSING	73.4	104.8	147.4	129.2	176.3
STRATEGY & RESOURCES	5.9	0.1	0.0	0.0	0.0
TRANSPORT, REGEN & CLIMATE	88.4	68.2	3.3	0.0	0.0
WASTE & STREET SCENE	0.9	0.0	0.0	0.0	0.0
TOTAL	**224.3**	**182.0**	**150.7**	**129.2**	**176.3**

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	Per TMSS 23/24	Dec Forecast £m
CFR - General Fund CFR	1,282	1,267
CFR - Housing Revenue Account	400	362
TOTAL	1,682	1,628
Borrowing	1,020	862
Other Long-Term Liabilities	302	302
Forecast - Total Debt as at 31 March 2022	**1,322**	**1,164**

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	1,628
Headroom to Operational Boundary (CFR)	68	122
Headroom to Authorised Borrowing Limit (CFR)	98	152
Projected External Debt at 31 March 2024	1,322	1,164
Headroom to Operational Boundary (debt)	428	586
Headroom to Authorised Borrowing Limit (Debt)	458	616

Interest Rate Forecast

The Council's treasury advisor, Link Asset Services, has provided the following forecast.

Updating of our forecasts 08 January 2024

Comparison of forecasts for Bank Rate today v. previous forecast

Bank Rate	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
08.01.24	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
07.11.23	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00	-
Change	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	0.00	0.00	0.00	0.00	0.00	-

The long term forecast for for borrowing rates is to reduce steadily from Sept 24 onwards. However, there remains significant uncertainty in gilt markets, strong cash balances should allow us to delay new borrowing until conditions are more favourable.

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

PWLB

PWLB Rates have risen significantly over the last two years with increasing UK base rates typically seeing a corresponding increase PWLB borrowing rates. Borrowing rates have fallen recently on expectations of interest rate cuts following falling inflation. There are local and global factors that could increase gilts such as the forthcoming UK general election, stubborn wage growth inflation and heightening tensions in the middle east.