Appendix 3

Treasury Management Outturn Report 2019/20

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Key Messages

All investment and borrowing transactions were in line with the principles approved 2019/20 Annual Treasury Strategy Statement and the Annual Ethical Investment Strategy.

Borrowing for the year was above expectations. Under normal circumstances borrowing for Cap expenditure would have been lower than planned. However, the impact of Coronavirus necessitated bringing forward borrowing planned for 2020/21 to protect the authority from unknown costs and risk and to benefit from the lower interest rates on PWLB borrowing.

During 2019/20 Bank of England Base Rates remained at 0.75% and inflation regularly dropped below target levels (2%). Interest rates remain at historically low levels though.

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 2019/20. 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 2019/20, the Full Council received the annual Treasury Management Strategy Statement (TMSS), whilst Cabinet were presented with the 2018/19 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.

The Strategy for 2019/20

The expectation for interest rates within the Treasury Management Strategy for 2019/20 anticipated that the Bank Rate would only increase by 0.5% during the financial year, however the Bank Rate remain unchanged at 0.75% throughout the year. Consequently Investment returns fell short of the 1% target set in the TMS

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. In practice increases in the cost of borrowing did not materialise due to domestic (Brexit) and international politics (e.g. US trade relation with China and more recently Coronavirus) as well as general cooling for many economies.

By August / September rates had fallen to new lows and the authority chose to borrow £40m of the planned £71m borrowing. This struck a balance between controlling the under borrowed position and avoiding the cost of carry from excessive cash reserves.

The impact of the Coronavirus in March 2020 saw the Authority borrow a further £40m; as liquidity issues became a priority as the level of uncertainty increased. The implications of the coronavirus will be covered below.

The Council operated within the Prudential Indicator Limits for 2019/20 set by the authority (see annex for details of limits).

The impact of the Coronavirus outbreak has yet to fully emerge, but has increased the need for liquid funds. The Council took additional borrowing to allow for this need; prior to Central Government announcing that they would make additional funding available.	Coronavirus Impact The full extent of the impact from Coronavirus will not be known for some time. However the immediate risk to the financial markets coupled with additional burdens on Council spending and uncertainty over funding have increased the need to carry larger cash balances. Consequently the Council borrowed £40m in March that would normally not have been taken until early in the following financial year or even later. This means there will be some interest cost incurred as a result of carrying these additional funds. Fortunately, the borrowing was taken at very low rates and was planned to be taken during 2020/21 anyway. This borrowing has the benefit of reducing the council exposure to interest rate risk from financial markets that are likely to see increased volatility in the short to medium term. Recommendation 1. Approve the actual 2019/20 prudential and treasury indicators presented in Annex 2 of this report. 2. Note the annual Treasury Management Outturn report for 2019/20.

Key Messages	Outturn Report

Key Messages

Slippage in major capital investment projects, such as the Heart of the City Programme, as well as accounting adjustment to PFI balances, has seen the CFR reduce slightly this year.

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

External Borrowing was higher than budgeted for as the council looked to cover the financial risks associated with Coronavirus towards the year end.

Investment balances also increased as a result of this additional borrowing with funds kept in highly liquid assets.

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 2018/19 and 2019/20, and the 2019/20 budget position including PFI liabilities.

	2018/19 Actual (£m)	2019/20 Actual (£m)	2019/20 Budget From TMS (£m)
General Fund CFR (non PFI)	791	807	830
General Fund - PFI Liabilities	400	373	390
Overall General Fund CFR	1191	1180	1220
HRA CFR	346	346	346
Total CFR	1537	1526	1566

After adjusting for PFI liabilities of £373m, the overall underlying financing requirement of the Authority was £1,180m (a decrease of less than 1% on the 2018/19 figure). The main variance to the TMS was as a result of adjustments to the value of PFI Liabilities recommended by auditors.

Actual capital investment for 2019/20 was £128.5m, slightly down on the £142.5m set out in the TMSS. Capital Expenditure financed by borrowing was £35.9m, £14.7m lower than anticipated at the start of the year.

Gross external debt, excluding PFI liabilities, has increased by a net £65m to £868m, after accounting for maturing loans, when compared to 2018/19.

As the 2018/19 TMSS predicted, the overall CFR position for the Housing Revenue Account's (HRA) of £346m is unchanged on last year. The HRA CFR primarily relates to legacy housing investment, such as the Decent Homes programme.

Key Messages:	External Context: The Economy and Interest Rates
UK Growth remains subdued – partly due to the effects of Brexit and partly due to cooling in the wider global economy. UK Base Rates were increased to 0.75% in August 2018, but there have been no further increases since, they were cut to just 0.1% in March 2020 and the likelihood of future increases looks low in the near term. Inflation has fallen to slightly below Bank of England target levels (2%), and is only expected to increase marginally above target in the next 2 to 3 years. Brexit remains a cause of major uncertainty in the UK. Coronavirus will cause a global recession, though length and severity of this remains uncertain.	**Economic growth** in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover. **Inflation** has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK. **UK. Brexit.** The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. Despite a new Prime Minister in October 19 and a general election in December 19, there still remains much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus. **WORLD GROWTH.** The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.

Key Messages:

Investment rates did not improve significantly during 2019/20 and anticipated increases to the UK bank rate did not happen – in fact it was dramatically cut in March 2020 as a response to the Coronavirus

There was an increase in market volatility during 2019/20, driven by both domestic politics and cooling in the global economy

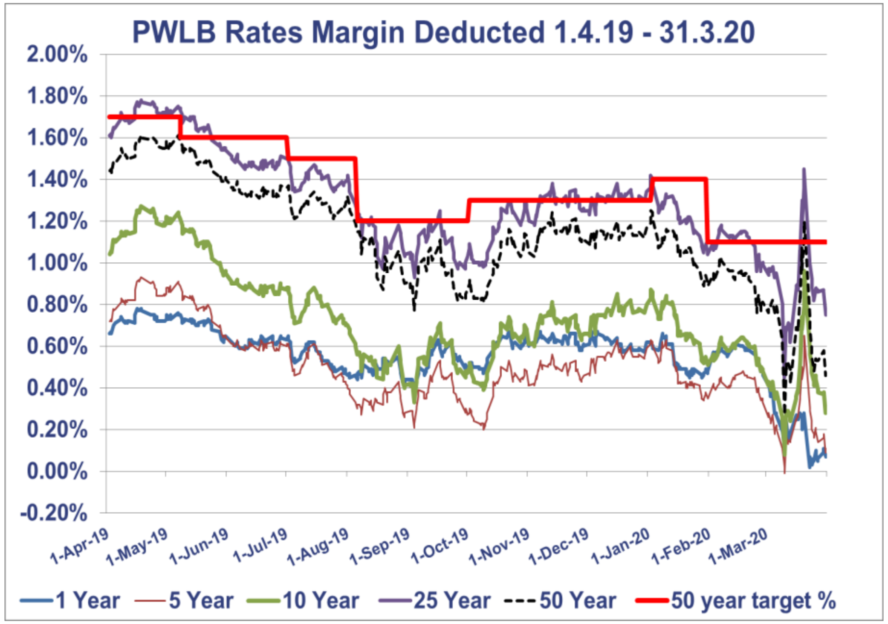
Margins on PWLB loans increased from 0.8% to 1.8% in Oct 19.

Investment policy continues to apply a cautious approach with investments made in low risk counterparties; but with correspondingly low returns.

Borrowing and Investment Rates

Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would rise from 0.75% to 1.25%. Expected growth was subdued by issues around Brexit and the bank rate did not increase, in fact it was dramatically cut in March as a response to the Coronavirus. Consequently Investment returns underperformed against the Treasury Strategy

The TMSS predicted modest increase in borrowing rates during the year but with significant volatility month on month (an example of this volatility in PWLB rates is shown in the graph below). This increase did not materialise and rates fell stedidly through to September 2019, at which point HM treasury increased the margin on rates from 0.8% to 1.8%. The council borrowed £40m just before this increase. A further £40m of borrowing was taken in March 2020 to increase the councils liquidity to help guard against the impact and uncretainty from Coronavirus.



Key Messages:

The strategy to reduce under-borrowing this year meant we undertook borrowing to more than cover the cost of 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 2019/20

The table below shows the breakdown for capital expenditure that should have been financed by external borrowing during the year. However, SCC borrowed a net £65m to support the Council's capital investment programme. The result of this additional borrowing is that the council's under borrowed position reduces; as does the associated interest rate risk the Authority is exposed to.

	£000	£000
Original borrowing estimate per 19/20 TMS		**50,600**
Expenditure on Schemes creating a Borrowing need:		
Heart of the City	20,118	
Leisure Facilities	13,767	
Essential Compliance	2,288	
Other	312	
Total Borrowing needed:		34425
Variance to TMSS		**- 16,175**

The 2019/20 TMS aimed to keep under borrowing largely the same. However the need for liquidity following uncertainty from the Coronavirus made a shift in strategy necessary. The low interest rate environment also made borrowing earlier than planned a realistic option.

Under borrowing remains at sustainable levels, but still carries significant interest rate risk – if and when interest rates do begin to rise. However, significant rate increases are not anticipated in the near future.

Key Messages:

Net borrowing for the year was £65.6m

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

The new borrowing undertaken is for longer duration, but the interest rates continue to be attractive and are much lower than the council average borrowing rate.

The PWLB added an additional 1% to their margin in Oct 19. Underlying rates remained low.

Details of the borrowing taken and repaid in 2019/20 are shown in the table below:

Loan Repayments and Borrowing 2019/20						
New Borrowing				Loans Repaid		
Counterparty	Amount (£000)	term (Years)	Interest Rate (%)	Counterparty	Amount (£000)	Original Rate (%)
PWLB	£5,000	42	1.75	PWLB	£450	12.5
PWLB	£5,000	42	1.75	PWLB	£4,000	1.85
PWLB	£5,000	43	1.74	Derbyshire CC	£5,000	1.98
PWLB	£5,000	50	1.73	SCR CA	£5,000	1.90
PWLB	£5,000	20	1.75			
PWLB	£5,000	21	1.77			
PWLB	£5,000	37	1.72			
PWLB	£5,000	41	1.69			
PWLB	£5,000	19	2.69			
PWLB	£5,000	20	2.72			
PWLB	£5,000	22	2.76			
PWLB	£7,000	23	2.77			
PWLB	£5,000	24	2.56			
PWLB	£5,000	25	2.57			
PWLB	£8,000	39	2.46			
	80,000				**14,450**	
Net borrowing	**65,550**					

Borrowing rates remain historically low. Current rates and forecasts for future rates have remained lower than anticipated in the Treasury Strategy. £40m of the above borrowing was taken as planned in September at exceptionally low rates. Following this, in Oct 2019, HM Treasury increased the margin on PWLB loans, effectively adding an additional 1% to all PWLB borrowing. A further £40m was borrowed in March 2020 to manage the emerging risks already discussed at rates that remained attractive.

The authority has acted proactively to secure its liquidity requirements. While this means interest costs are incurred earlier than anticipated, borrowing would have been required early in 2020-21. Any additional borrowing will be taken cautiously, whilst keeping a close watch on forecasts of longer-term rates. If rates are forecast to increase significantly in the near future, we will take out additional long-term debt in advance of these increases, to lock in the current low interest rates.

The exceptionally low rates achieved on the mid-year borrowing and higher than forecast investment balances generated savings within the capital financing budget this was offset by additional borrowing in March 2020 but still resulted in an underspend for the year. This underspend was used to help support the corporate budget. The average rate of interest paid on the Council's external debt has decreased to 3.90% in 2019/20 compared to 4.04% 2018/19.

As at 31 March 2020, the loans portfolio, excluding PFI liabilities, totalled £868m, and indicates the Council is under borrowed by £285m – down £49m on 2018/19 (£334m), this is a result of borrowing above the requirements of this year's capital programme and MRP payments.

Key Messages:	
There has been no debt rescheduled during 2019-20 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 £54m compared to 31 March 2019 – primarily as a result of PWLB borrowing taken in March 2020 and additional grants related to the Coronavirus. Investment returns remain subdued – due to market conditions and the policy to invest in low risk counterparties.	<u>Debt Rescheduling</u> No rescheduling was done during the year as differential between PWLB new borrowing and premature repayment rates made rescheduling unviable. **Investment Outturn** <u>Ethical Investment Policy</u> 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. <u>Investments held by the Council</u> The Council maintained an average balance of £145m of internally managed funds compared to the Council only having funds for day to day cash flow purposes. As at 31st March 2020, investments were £168m; up £54m on the previous year. However the late borrowing and additional government grant has inflated this figure. The Council had no liquidity difficulties during the year. The internally managed funds earned an average rate of return of 0.85% against a budgeted return of 1.0%. This should still be judged a good achievement as the expected increases to underlying bank rates did not materialise. The Council would not plan to have such high cash balances under normal circumstances, but the strategy of increasing liquidity is essential to deal with the dramatic increase in uncertainty risks associated with the Coronavirus.

Annex 1: Outturn Position with General Fund & HRA Split

The overall Treasury position as at 31 March 2020 (excluding debt from PFI and finance leases) split across the General Fund and the Housing Revenue Account was as follows:

Authority	31 March 2019 Principal	Rate/ Return	31 March 2020 Principal	Rate/ Return
Total debt	803	*4.04%*	868	*3.92%*
CFR	1137		1153	
Over / (under) borrowing	-334		-285	
Total investments	114	*0.76%*	168	*0.85%*
Net debt	689		700	

General Fund	31 March 2019 Principal	Rate/ Return	31 March 2020 Principal	Rate/ Return
Total debt	518	*4.00%*	590	*3.97%*
CFR	791		807	
Over / (under) borrowing	-273		-218	
Total investments	114	*0.48%*	168	*0.76%*
Net debt	404		422	

HRA	31 March 2019 Principal	Rate/ Return	31 March 2020 Principal	Rate/ Return
Total debt	285	*4.54%*	279	*4.57%*
CFR	346		346	
Over / (under) borrowing	-61		-67	
Total investments	0	*n/a*	0	*n/a*
Net debt	285		279	

Annex 2: Prudential and Treasury Indicators

During 2019/20, 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:

Actual prudential and treasury indicators	**2018/19 Actual £'000**	**2019/20 Actual £'000**	**2019/20 Estimate (TMS £'000**
Capital expenditure:			
General Fund	*148,812*	*71,360*	69,800
HRA	*59,511*	*57,126*	72,700
Total	*208,323*	*128,486*	142,500
Capital Financing Requirement:			
General Fund	1,191,113	1,180,415	1,220,000
HRA	345,914	345,867	345,867
Total	1,537,027	1,526,282	1,565,867
Gross debt	1,203,082	1,241,400	1,280,100
Net External debt (gross debt less investments)	1,089,088	1,073,277	1,209,300
Investments			
Longer than 1 year	0	0	Nil
Under 1 year	113,994	168,123	70,800
Total	113,994	168,123	70,800

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The Council's net external debt (loans plus PFI balances) has decreased by £15.8m, whilst our overall need for borrowing, which is represented by the CFR, has increased by £10.7m.

Movements in Net Debt	2019/20 Movement £000
New Borrowing	65,550
Less PFI Repayments	-27,232
Less increase in Investment	-54,129
Total	-15,811

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 despite taking on a larger than expected level of new borrowing in year. Funds received from the £40m taken in March 2020 remained unspent at year end and increased investments, consequently reducing the net position.

These deposits were placed with an array of AAA rated, instant access money market funds and fixed-term and call account deposits with banks. This investment policy meant that we sought to minimise security risks and increase the liquidity of our deposits. Deposit returns were relatively low at 0.85% (albeit above the average UK Bank Base Rate of 0.75% during 2019/20).

External debt payments haven't changed dramatically in year. An accounting adjustment to MRP on PFI arrangements has increase costs. This will have a one year effect. MRP is now being charged, on parts of the HotC II project and this will increase as more of the overall scheme is classified as being in use.	**Financing Costs As a proportion of Revenue**

Ratio of financing costs to net revenue stream:	OUTTURN 2018/19 £'000	2019/20 Act £'000
Non-HRA Including PFI)	17.7%	20.9%
Non-HRA Excluding PFI)	8.6%	9.2%
HRA	9.5%	8.9%

The information in the above take account of the actual costs associated with external loans plus accounting adjustments for items such as MRP and premiums and discounts adjustment.

The Increase of 3.2% on Non HRA including PFI is largely because of an increase in MRP associated with PFI arrangements following recommendation from auditors. The PFI MRP increased to £27.2M (£11.8m 2018/19) but should revert to more normal levels next year.

The cost excluding PFI arrangements has also increased; the main factor in this is that MRP is now being charged on elements of the Heart of the City Project.

HRA has seen a small reduction in costs, debt has reduced slightly but the main reduction comes from a drop in charges associated with premium and discount charges.

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