

Treasury Management Review as at 30th September 2020

Revenue Implications of Treasury

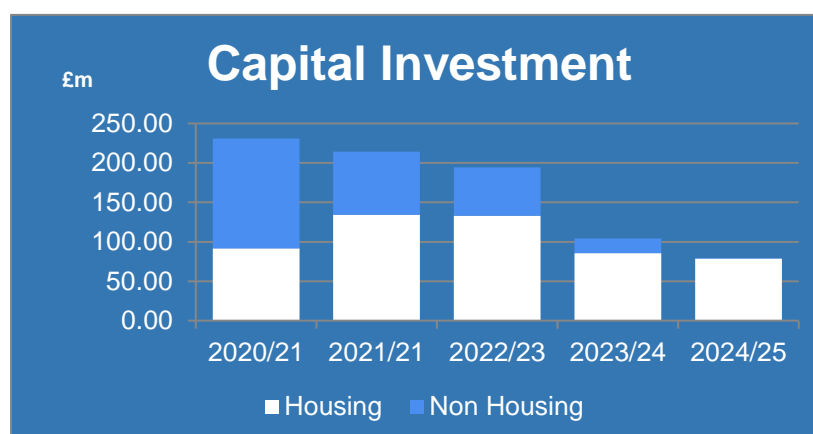
Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 30th September 2020 and the potential implications for revenue budgets.

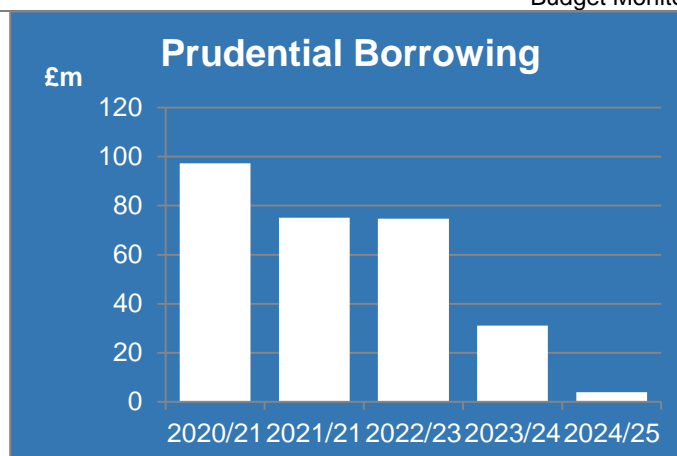
In addition, Appendix 1 sets out Indicators not already covered in the main report but are required to satisfy the Council's Prudential Code and Treasury Management Code of Practice obligations.

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 20/21 to 24/25 totals £822.5m	As at 31 st August 2020, the <u>approved</u> capital budget, for the period from 2020/21 through to 2024/25, totals £822.5m (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. 34% (£282m) of capital expenditure	The proportion of this investment funded by prudential borrowing over this period will be £282m. On this basis, approximately 34% 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.
1.5 Graph - Prudential borrowing over next 5 years	The following graph shows how this element of funding varies over the five year period.



1.6 The sale of parts of HoTC II programme could reduce prudential borrowing and interest charges

It is anticipated that elements of the HoTC II programme, which forms a substantial proportion of the Prudential Borrowing, will be subsequently sold to developers and this will reduce the prudential borrowing and interest charges. Also, within the overall prudential borrowing figure (£282m), £55m relates to Housing activity which is covered by the HRA business plan.

1.7 There will be an additional £7.8m pa in interest costs and £5.6m pa MRP if no borrowing is recovered from future sales

However, by the end of this period if the full amount of prudential borrowing had been incurred and not recovered from future sales, this would result in

- an additional £7.8m pa in interest costs (at an estimated rate of circa 2.75% - including the increased certainty rate margin imposed by HMT) and
- a further £5.6m pa in Minimum Revenue Provision (MRP), assuming an average 40 year asset life and excluding £55m worth of HRA prudential borrowing in the 21/22 to 23/24 period

1.8 Prudential borrowing in 20/21 projected to increase from £74.4m to £97.3m

The **latest projected** capital expenditure estimates for 2020/21 compared to the **original budget** position shows that Prudential Borrowing in 2020/21 is projected to increase from £74.4m to £97.3m. The potential impact of this is shown in the table below to illustrate how material the increased expenditure could be. In reality MRP isn't charged until the following year, and many HOTC projects are still not live and so MRP can be deferred until completion so the actual impact is likely to be smaller

Estimated Additional Revenue Costs	Revised £'000	Original £'000	Variance £'000
Interest Costs (@ 2.75%)	£2,675	£2,046	£629
MRP Costs (assuming a 40 year asset life)	£2,206	£1,860	£346
Potential additional revenue costs	£4,881	£3,906	£975

1.9 Cash balances have remained strong and delayed borrowing

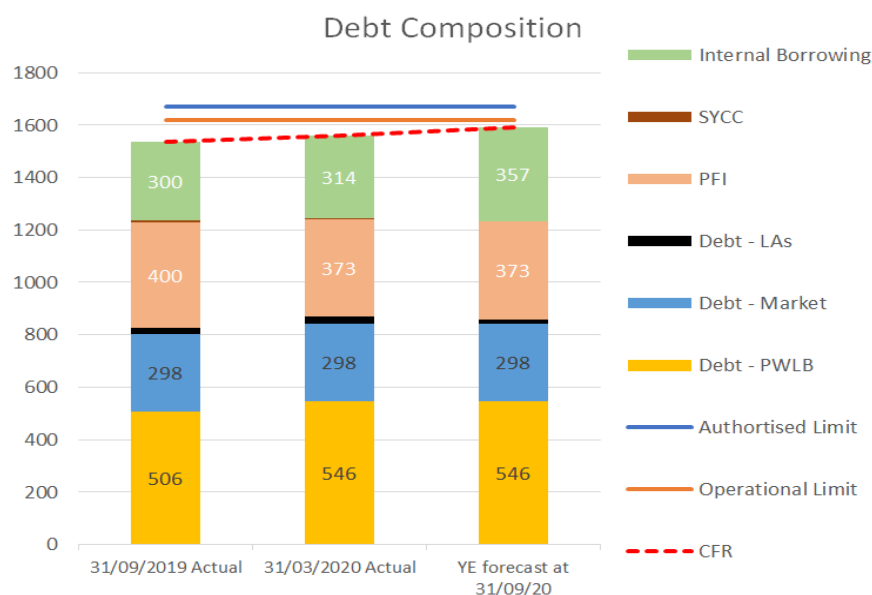
Cash balances have remained strong and have afforded us the luxury of delaying borrowing, potentially into next year. Irregular funding flows from government partially created this opportunity, although uncertainties around Covid costs and movement in borrowing costs mean we approach this strategy with appropriate caution.

2. Update on Debt

2.1 Current Debt Composition (assumes full years' cap ex in CFR)

Borrowing from internal sources will increase.

This is supported by economic forecasts and low returns on investments.



The above table shows:-

- The Council is using a substantial proportion of its own internally generated cash resources to fund capital expenditure, rather than taking external borrowing. If no further borrowing is externalised the Council will have borrowed internally up to £357m by the Year end
- 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.
- We took £40m of PWLB borrowing in late March 20. This was borrowing planned for 20/21, but Covid uncertainty, low borrowing costs and the underlying need to manage our internal borrowing risk made this a prudent decision despite the cost of carry in the short term.
- The level of internal borrowing is a mixture of general fund (£281m) and HRA (£76m). This level of internal borrowing is not untypically high, but it produces a risk that future external borrowing to reduce this level of internal borrowing may be at a higher rate than can be currently obtained from the market.
- 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 is forecast to reduce, we do not anticipate breaching the Boundary this year.
- In addition to that, there is further headroom of circa £40m before borrowing reaches the maximum level currently authorised by Full Council.
- The HRA CFR is £355m – which is £70m below the authorised limit and £33m below the operational limit (that was set at the previous HRA debt cap level).

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 2020/21 Treasury Management Strategy Statement (TMSS) set out plans to borrow an additional £69.3m mainly to fund in-year prudential borrowing (at the original budgeted level).

So far this financial year:-

- £40m of this borrowing was taken early to mitigate Covid risk and prior to Central Government announcing additional funding, and it is now felt the balance of borrowing can be delayed until 21/22 though this decision will be monitored closely.
- £9m of loans from other Local Authorities has been repaid so far this year.
- Only limited 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
- In terms of the HRA - no borrowing has been undertaken to date and no borrowing is anticipated this financial year

2.3 No rescheduling of our borrowing has been undertaken

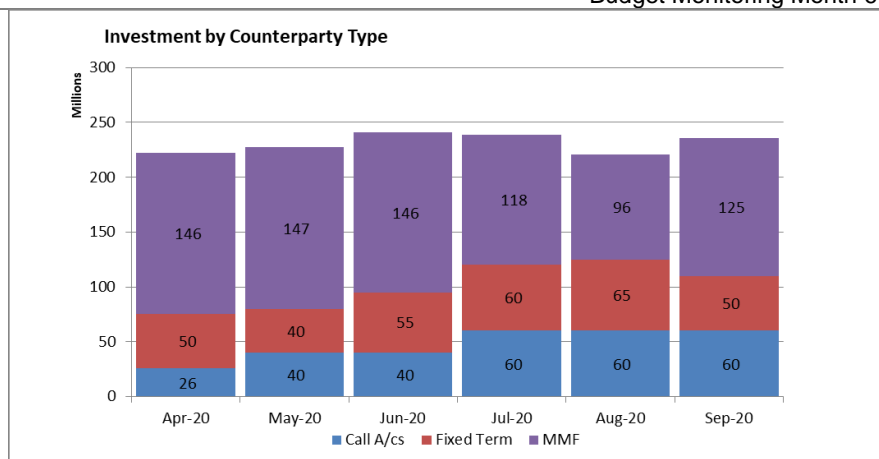
No rescheduling of any of our borrowing has been undertaken. Whilst we will keep this position under review, currently charges to reschedule PWLB debt more than the benefits of doing so, despite the current cheap borrowing levels.

3. Update on Investments

3.1 Investment balances have remained high but returns are gradually falling.

Money Market Funds (MMF's) provide instant access to funds which is important give current uncertainties

	Average Balance	Average Return
April	£237.4m	0.40%
May	£231.0m	0.35%
June	£236.3m	0.39%
July	£254.2m	0.31%
August	£239.7m	0.29%
September	£238.9m	0.27%
YTD	£235.4m	34.00%



3.2 COVID and trade deal negotiation will continue to weigh on economic conditions

Possibility of 0% interest rates

No investments for longer than 365 days

There are still risks associated with the trade deal being negotiated between the UK and Europe, however the financial impact of Covid has dramatically overshadowed this risk. Interest rates could well be cut to zero in 20/21, and negative rates are still a possibility.

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, this could mean we incur negative yields on some investments, particularly those prioritising liquidity

There are currently no proposals for the Council to invest sums for periods longer than 365 days.

4. Revenue

4.1 Treasury Management forecast underspend in year, largely from avoiding external borrowing costs.

Exposure Interest rate risk increases as a consequence

As at September 2020	Forecast £m	Budget £m	Variance £m
Interest Costs (net of HRA recharge)	21.2	23.2	(2.0)
MRP Costs	17.0	20.3	(3.3)
Debt Management Costs	0.4	0.4	(0.0)
Gross Cost	38.6	43.9	(5.3)
Less Investment/Other Income	(0.4)	(0.2)	(0.2)
Less Internal Recharges*	(4.6)	(8.9)	4.3
Net Cost	33.6	34.8	(1.2)

* Internal recharges includes prudential borrowing costs (interest) recharged to services and debt management cost recharged to General Fund and HRA

The above table shows:

- Net Costs are forecast to underspend compared to budget – as a result of
 - interest savings arising from deferring borrowing and lower rates than forecast.
 - lower MRP costs based on underspend against the 2019/20 capital programme.

4.2 Financing Costs to Net Revenue generally increase.

Ratio of Financing Costs to Net Revenue Stream:	2019.20 Actual £000's	2020.21 Budget £000's	2021.22 Estimate £000's	2022.23 Estimate £000's	2023.24 Estimate £000's
Capital Financing Costs *	£38,512	£43,114	£39,899	£40,293	£41,233
Net Revenue	£473,843	£497,759	£494,948	£500,103	£500,103
Ratio	8.13%	8.66%	8.06%	8.06%	8.24%

Repayment of SYCC debt in 20/21 reduces cost in 21/22

* [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. The 20/21 budget increase relates to full year effect of new borrowing in March 20, increased MRP charges and a loss of offsetting income as interest rates fall.
- The South Yorkshire County Council debt is repaid this year, this is over £4.5m this year and the reason that costs are down in 21/22 versus budget despite an additional £40m of general fund borrowing being forecast.
- 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 22/23 to 23/24 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 risk significantly, increasing the cost of servicing new borrowing	Forecasting reserves that support the current borrowing position alongside borrowing needs to ensure measures to address internal borrowing can be undertaken in a planned and measured way
		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 2020/21 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.
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The Section 151 Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2020/21.

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

	2020/21 £m	2022/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	Total £m
Non Housing	138.9	80.0	61.5	18.7	0.0	299.1
Housing	91.8	134.3	133.0	85.7	78.6	523.4
Total	230.7	214.3	194.5	104.3	78.6	822.4
Capital Receipts	29.3	36.7	11.8	9.1	8.8	95.7
Capital Grants & Contributions	54.0	34.7	10.5	8.5	10.2	117.9
Revenue Contributions	50.1	67.9	97.4	55.7	55.7	326.8
Prudential Borrowing	97.3	75.1	74.7	31.0	3.9	282.2
Total	189.2	166.0	130.0	137.1	74.2	696.5

Breakdown of Capital Expenditure

Capital Expenditure	2020/21	2021/22	2022/23	2023-24	2024/25	Total
ESSENTIAL COMPLIANCE & MAINT	9.6	-	-	-	-	9.6
HOUSING GROWTH	45.7	78.1	75.3	28.7	21.6	45.7
HOUSING INVESTMENT	46.1	56.2	57.7	57.0	57.0	46.1
HEART OF THE CITY II	66.7	52.9	41.6	0.7	0.0	66.7
QUALITY OF LIFE	19.5	17.6	17.7	17.9	-	19.5
PEOPLE CAPITAL & GROWTH	16.5	3.6	2.2	0.0	-	16.5
ICT	1.4	-	-	-	-	1.4
TRANSPORT	15.6	1.3	-	-	-	15.6
GREEN & OPEN SPACES	1.5	0.3	-	-	-	1.5
ECONOMIC GROWTH	8.2	4.3	0.0	0.0	-	8.2
TOTAL	230.7	214.3	194.5	104.3	78.6	230.7

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	Per TMSS £m	Forecast £m
CFR - General Fund CFR	1,203.2	1,236.1
CFR - Housing Revenue Account	345.9	354.9
TOTAL	1,549.1	1,591.0
Borrowing	828.4	860
Other Long Term Liabilities	390	358
Forecast - Total Debt as at 31 March 2020	1,218.4	1,218

Authorised and Operational Borrowing Limits

Authorised and Operational Limits on Debt	Per TMS £m	Forecast £m
Authorised Limit	1,670	1,670
Operational Boundary	1,620	1,620
Projected Year End Capital Financing Requirement	1,588	1,591
Headroom to Operational Boundary	32	29
Headroom to Authorised Borrowing Limit	82	79

Interest Rate Forecast

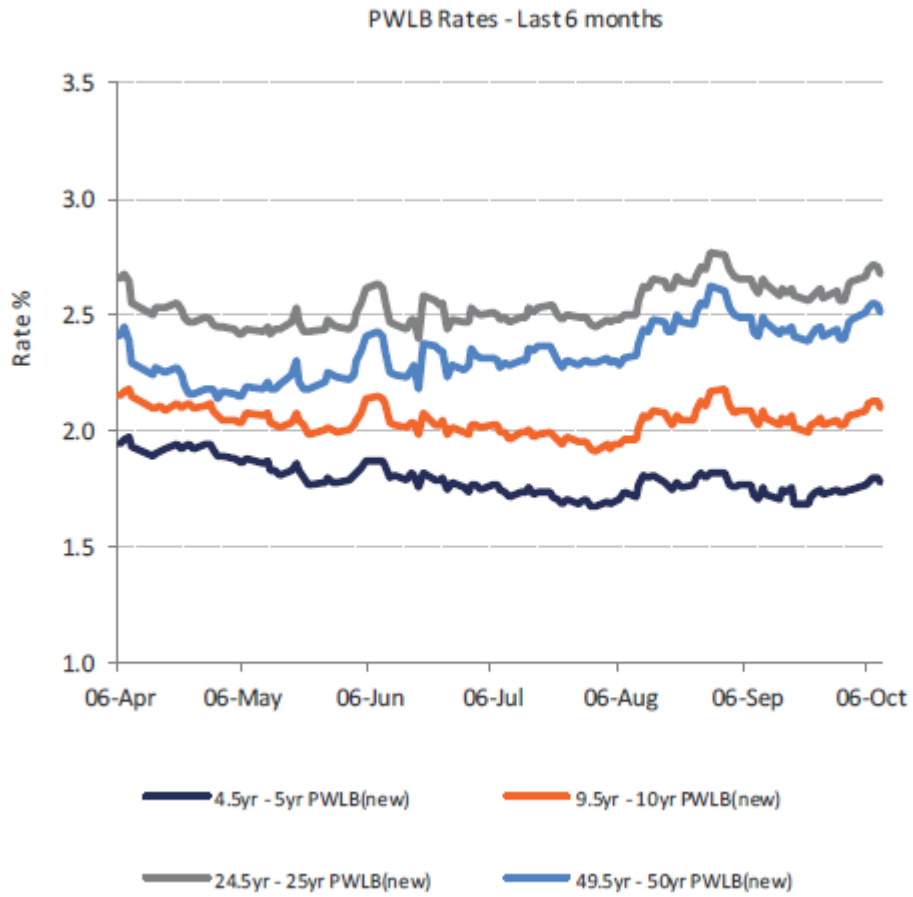
The Council's treasury advisor, Link Asset Services, has provided the following forecast. Any increases in rates are forecast to be very slow which supports the strategy of delaying further borrowing. This position will be monitored to ensure it remain prudent.

	PWLB (Includes Certainty Rate)					Forward Rates			
	1y	5y	10y	25y	50y	3M/3M FWD	3M/6M FWD	3M/9M FWD	6M/12M FWD
	1.77	1.78	2.1	2.68	2.51	-0.01	-0.04	-0.08	-0.05
Interest Rate Forecasts									
Bank Rate	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	
Link	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Cap Econ	0.10%	0.10%	0.10%	0.10%	0.10%	-	-	-	-
5Y PWLB RATE									
Link	1.90%	2.00%	2.00%	2.00%	2.00%	2.00%	2.10%	2.10%	
Cap Econ	1.85%	1.85%	1.85%	1.85%	1.85%	-	-	-	
10Y PWLB RATE									
Link	2.10%	2.10%	2.10%	2.10%	2.20%	2.20%	2.20%	2.30%	
Cap Econ	1.95%	1.95%	1.95%	1.95%	1.95%	-	-	-	
25Y PWLB RATE									
Link	2.50%	2.50%	2.50%	2.60%	2.60%	2.60%	2.70%	2.70%	
Cap Econ	2.30%	2.30%	2.30%	2.30%	2.30%	-	-	-	
50Y PWLB RATE									
Link	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	
Cap Econ	2.20%	2.20%	2.20%	2.20%	2.20%	-	-	-	

PWLB

On the 9th October 2019, HM Treasury informed Authorities that the fixed margin above the Government's cost of borrowing (gilt rates) would be increased by 100 basis points overnight – taking the margin to 180bps.

This pushed the available PWLB rate for 50 year borrowing from 1.62% to 2.62% overnight; and returning borrowing levels to levels that were last available in 2018. This higher margin still remains in place but there is a consultation ongoing that may see 100 bps come off the PWLB margin providing Authorities accept certain concessions limiting around borrowing for commercial activity.



PWLB rates have not moved materially over the first half of the year, though rates for short duration loans have fallen as UK gilts turned negative.