Revenue Implications of Treasury

1. Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 30th June 2023 and the potential implications for revenue budgets.

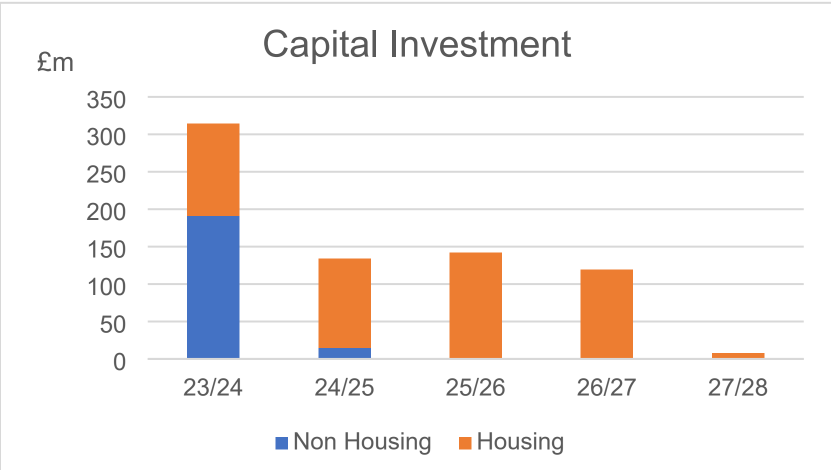
In addition, Appendix 1 sets out Indicators not already covered in the main report but are required to satisfy the Council's Prudential Code and Treasury Management Code of Practice obligations.

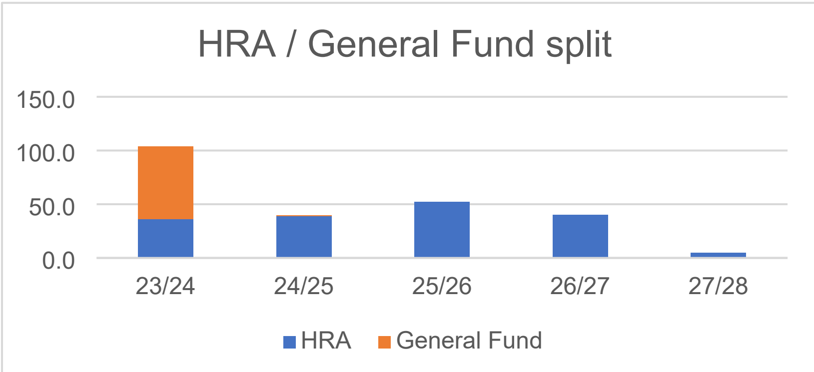
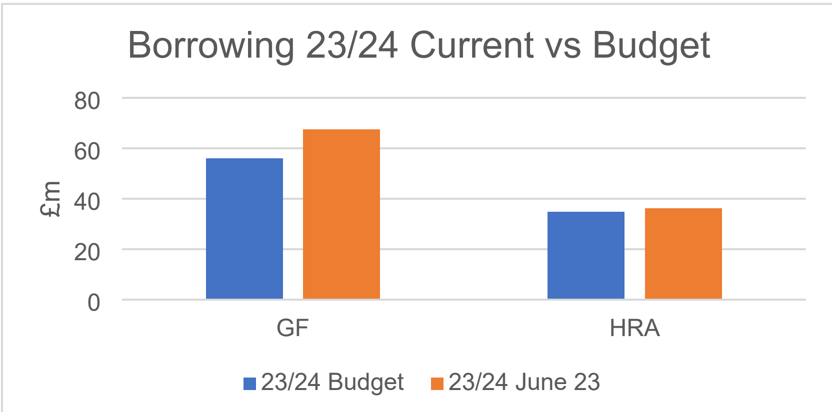
2. Summary.

Investment income is higher than budgeted, this results in the treasury budget forecasting to underspend by £2.6m in 2023/24. Interest rates for new borrowing are also much higher than at budget setting but this cost can be mitigated by delaying borrowing or potentially avoiding new borrowing in 2023/24 if cash balances remain healthy.

The cause of the dramatic rise in rates is due to 'stubbornly' high inflation figures, meaning bank rates are now anticipated to push higher and remain there longer than was expected at budget setting.

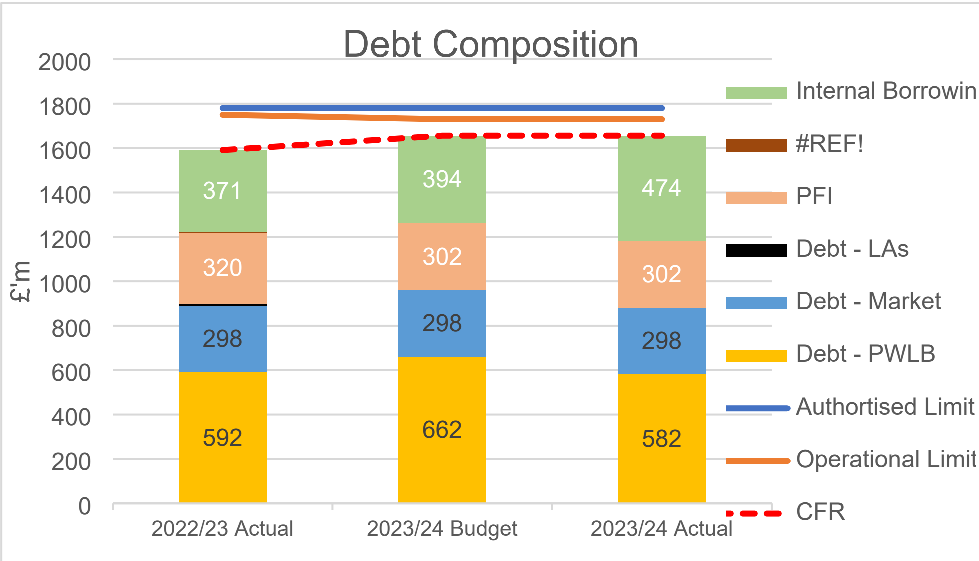
3. Capital Investment & Funding

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 £717m**	As at June 23, the approved capital budget, for the period from 2023/24 through to 2027/28 totals £717m (a full breakdown is shown in Appendix 1). This figure at budget setting was £605m, the increase represents some of the slippage from 22/23.
1.3	**Housing and non-housing split of planned investment**	The split of this planned investment across housing and non-housing are shown in the graph below: - 
1.4	**Borrowing increases are largely due to**	The proportion of this investment funded by prudential borrowing over this period has increased to £240m (34%). This compares to £220m

	slippage from 22/23	(36%) when budgets were set. Again, this is expected due to the larger overall Capital investment.
1.5	**Graph - Prudential borrowing over next 5 years**	The following graph shows how this element of funding varies over the five years. General Fund borrowing (£68m) makes up the majority of borrowing in the near term, but the HRA forecasts to borrow more from beyond 23/24. 
1.6	**Slippage from 22/23 impacts 23/24 borrowing**	Most of the increase in prudential borrowing can be seen in 23/24 on the general fund requirement. 
1.7	**It is hoped that new borrowing can be delayed until interest rates are more favourable.**	Economics conditions have seen the cost of borrowing rise dramatically in the first quarter of this year, forecasts are for more uncertainty but with cost eventually falling back by 24/25. The timing of this reduction has moved further out as economic data, particularly inflation continues to disappoint markets. 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 23/24 forecasts for prudential borrowing (£91m) was externalised, current interest rates of around 5.4% would see an additional (fully year cost) of around £4.9m.
1.8	**Cash balances have remined strong and so**	Cash balances have remained strong, partially due to underspends in the Capital programme (22/23) and have afforded us the luxury of

	we have delayed borrowing.	delaying borrowing. Irregular funding flows from government partially created this opportunity. Balances are expected to decrease over the year but have remained level during the first quarter after the pension prepayment was made.

4. 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 with less debt externalised than budgeted.**	 The above table shows: - • 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 £474m by 31 March 2024. This is an increase to the budgeted position, but external sources are reduced accordingly. • This approach is taken because we pay more to borrow externally than we receive on any cash we invest; cash balances are relatively healthy and interest rates are expected to fall in the medium term. The associated interest rate risk should be noted, i.e., rates could be higher in future when we need to borrow externally. • 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**	There are no proposed changes to: - • Treasury Management Strategy Statement • Annual Investment Strategy

	other than to delaying external borrowing	• 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 until rates are more favourable. Short term loans may be taken if Interest rates do not come down as quickly as expected. This financial year: - • Pension prepayment of £134m had material impact on liquidity but cash balances still remain strong. • £20m of loans will be repaid during 23/24 • There is a much-reduced probability of 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. • There are no significant shifts in planned HRA borrowing despite major cost increases in the housing / construction market. Some planned cap ex has slipped in to 25/26, this further supports the plan to delay new borrowing.
2.3	**No rescheduling of our borrowing has been undertaken**	No rescheduling of any of our borrowing has been undertaken. We will keep this position under review, currently the charges to reschedule PWLB debt are higher than the benefits of doing so.

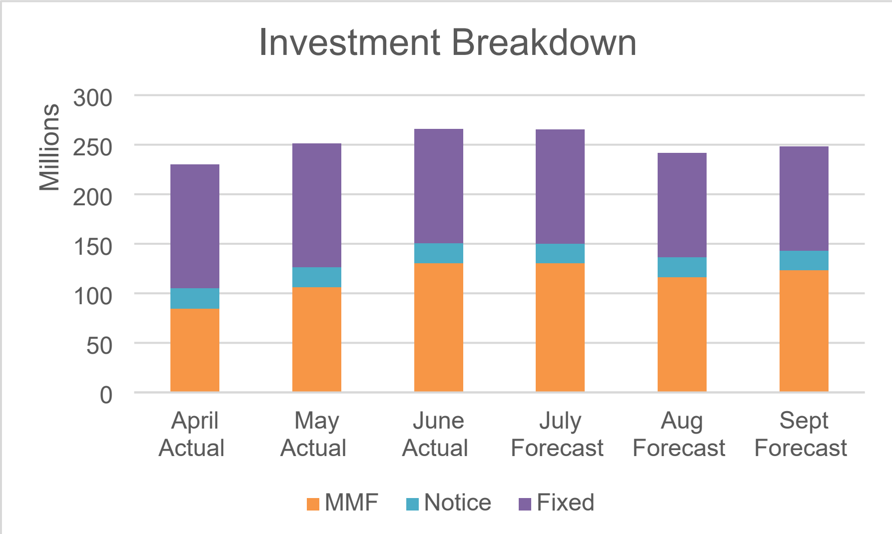
5. Update on Investments

3.1 **Investment balances have increased and rates are forecast to be higher than budgeted for.**

Investment balances have increased over the first Quarter but are forecast to fall over the rest of the financial year. The year end forecast position of £220m supports the decision to delay borrowing. Due to increasing interest rates, investment balances are making a significant contribution to revenue (see 4.1). Rates are forecast to remain higher for longer until material reductions in inflation are seen.

	Month End Balance (£M)	Average Return
April Actual	£230.0	3.85%
May Actual	£251.1	3.97%
June Actual	£269.0	4.24%
July Forecast	£266.5	4.40%
Aug Forecast	£242.6	4.50%
Sept Forecast	£249.4	4.75%
YTD Ave	£251.4	4.29%

3.2	**Breakdown of investment by type**	Fixed investments have been allowed to mature during the first quarter to replace the MMF balances which were reduced by the pension prepayment at the start of the year. MMF balance offer liquidity with fixed investment offering higher returns. Our investment profile will continue to balance these two factors.



3.3	**Sufficient liquidity is being maintained, balances are expected to reduce, but income from investments is higher than budgeted.** **There are no investments for longer than 365 days**	Most Local Authorities are in a similar position to Sheffield in that they currently have significant cash balances. However, we are beginning to see more Locals looking for cash, with higher alternative borrowing costs, lending rates to locals have increase dramatically. Borrowing costs have also increased 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 due to the increased rate environment. 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.

6. Revenue

4.1 Treasury Management costs are in line with budget. Income is much higher than originally forecast.

Main Revenue Variances June 23	Budget £m	Forecast £m	Variance £m	
Investment income	-5.9	-8.9	-3.0	Fav
Borrowing Costs	33.1	33.1	0.0	*
Minimum Revenue Provision	15.1	15.1	0.0	
Total	42.30	39.30	-3.00	Fav

*Borrowing Costs contains £0.5m provision for new borrowing in 23/24.

The above table shows:

- Costs are forecast in line with budget however borrowing costs contains £0.5m provision for new borrowing in 23/24. While the chance of borrowing has decreased the cost of doing so has gone up. It is prudent to keep this contingency in place until later in the year when borrowing needs crystalise.
- Full year impact of anticipated higher interest rates on income.

4.2 Financing Costs to Net Revenue generally increase but with a noticeable one off reduction in the current year.

23/24 shows a decrease due to Investment income and delays to borrowing costs.

Ratio of Financing Costs to Net Revenue Stream:	2022.23 Actual	2023.24 Budget	2024.25 Est	2025.26 Est	2026.27 Est
General Fund	6.3%	5.9%	8.6%	8.9%	8.8%
HRA	7.6%	6.5%	7.5%	7.7%	8.8%

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:

- Improvement in the ratio due lower net costs. Higher income and not externalising debt have improved this position.
- The improvement is short term as debt is still needed eventually and investment returns will return to normal levels.
- General Fund looks to be a much lower improvement on 22/23 than the HRA but there are additional MRP costs which increased this ratio. In the Treasury Strategy this ratio was 7.0%.
- The GF increase in 24/25 is due to the remaining HOTC schemes going live and MRP charges beginning, plus additional borrowing cost.
- 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 23/24 to 24/25 is funded by prudential borrowing increases.

7. Risk Assessment

		Risk	Mitigation
5.1	**The principal risks associated with treasury management.**	Loss of investments because 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

8. 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 quarter of 2023/24

9. 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 June 23	2023/24 Forecast £m	2023/24 Budget £m	2023/24 Variance £m
Non-Housing Expenditure	191.0	107.2	83.8
Housing Expenditure	123.2	106.9	16.3
Total	**314.3**	**214.1**	**100.1**
Financed by:			
Capital Receipts	20.6	8	12.4
Capital Grants and Contributions	126.1	58	68.3
Revenue Contributions	63.8	57	6.5
Prudential Borrowing	103.8	91	12.9
Total	**314.3**	**214.1**	**100.1**

Breakdown of Capital Expenditure

Capital Expenditure	**2023/24 £m**	**2024/25 £m**	**2025/26 £m**	**2026/27 £m**	**2027/28 £m**	**Total £m**
ADULT HEALTH & SOCIAL CARE	6.2	0.0	0.0	0.0	0.0	6.2
COMMUNITIES, PARKS & LEISURE	25.2	0.1	0.0	0.0	0.0	25.3
ECONOMIC DEVELOPMENT & SKILLS	14.7	4.1	0.6	0.0	0.0	19.4
EDUCATION, CHILDREN & FAMILIES	20.0	0.6	0.0	0.0	0.1	20.7
HOUSING	123.2	118.9	141.5	119.2	7.5	510.5
STRATEGY & RESOURCES	6.6	0.0	0.0	0.0	0.0	6.6
TRANSPORT, REGEN & CLIMATE	117.6	10.3	0.2	0.0	0.0	128.1
WASTE & STREET SCENE	**0.8**	**0.0**	**0.0**	**0.0**	0.0	0.8
	314.3	134.1	142.3	119.2	7.6	717.5

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	Per TMSS 23/24 £m	June 23 Forecast £m
CFR - General Fund CFR	1,282.0	1,275.0
CFR - Housing Revenue Account	399.7	382.0
TOTAL	1,681.7	1,657.0
Borrowing	960.0	890.2
Other Long-Term Liabilities	302.0	302.0
Forecast - Total Debt as at 31 March 2022	**1262.0**	**1192.2**

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	1,745	1,664
Headroom to Operational Boundary (CFR)	5	86
Headroom to Authorised Borrowing Limit (CFR)	35	116
Projected External Debt at 31 March 2022	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. The increase in the bank rate between their two forecasts is indicative of the level of volatility. This change was caused by the unexpected static inflation report resulting in the bank increasing the base rate by 0.5%.

Bank Rate	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
26.06.23	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
25.05.23	4.75	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50	2.50	2.50	2.50
Change	0.25	0.50	0.50	0.75	0.75	0.75	0.75	0.50	0.50	0.25	0.25	0.00	0.00

The long term forecast for for borrowing rates is to reduce steadily from 24/25 onwards. This had been previously expected this year but keeps being pushed backwards on negative economic data.

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 26.06.23													
	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26
BANK RATE	5.00	5.50	5.50	5.50	5.25	4.75	4.25	3.75	3.25	2.75	2.75	2.50	2.50
3 month ave earnings	5.30	5.60	5.50	5.30	5.00	4.50	4.00	3.50	3.00	2.70	2.60	2.50	2.50
6 month ave earnings	5.80	5.90	5.70	5.50	5.10	4.60	4.00	3.50	3.00	2.70	2.60	2.60	2.60
12 month ave earnings	6.30	6.20	6.00	5.70	5.30	4.80	4.10	3.60	3.10	2.80	2.70	2.70	2.70
5 yr PWLB	5.50	5.60	5.30	5.10	4.80	4.50	4.20	3.90	3.60	3.40	3.30	3.30	3.20
10 yr PWLB	5.10	5.20	5.00	4.90	4.70	4.40	4.20	3.90	3.70	3.50	3.50	3.50	3.40
25 yr PWLB	5.30	5.40	5.20	5.10	4.90	4.70	4.50	4.20	4.00	3.90	3.80	3.80	3.70
50 yr PWLB	5.00	5.10	5.00	4.90	4.70	4.50	4.30	4.00	3.80	3.60	3.60	3.50	3.50

PWLB

Up to August 22 PWLB rate were static, the problem of inflation and energy costs became a huge problem, and the bank of England were forced to increase the base rate. The general situation is for volatility in bond yields to endure as investor fears for inflation and/or recession ebb and flow.