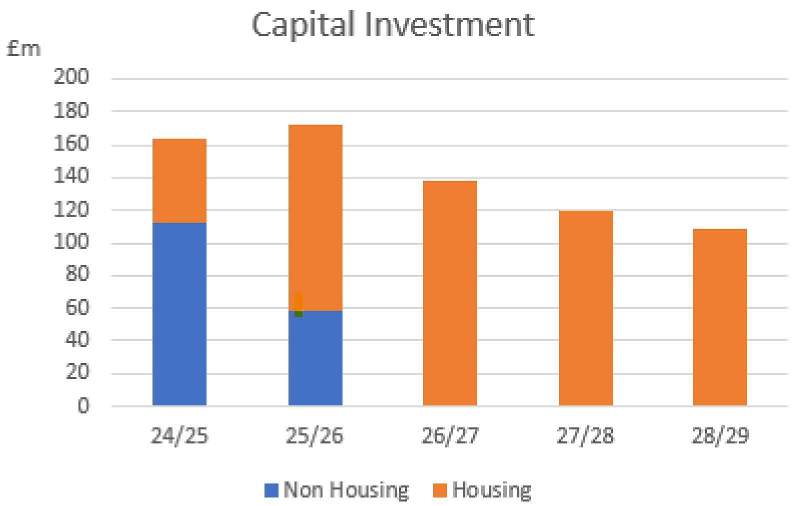
Revenue Implications of Treasury

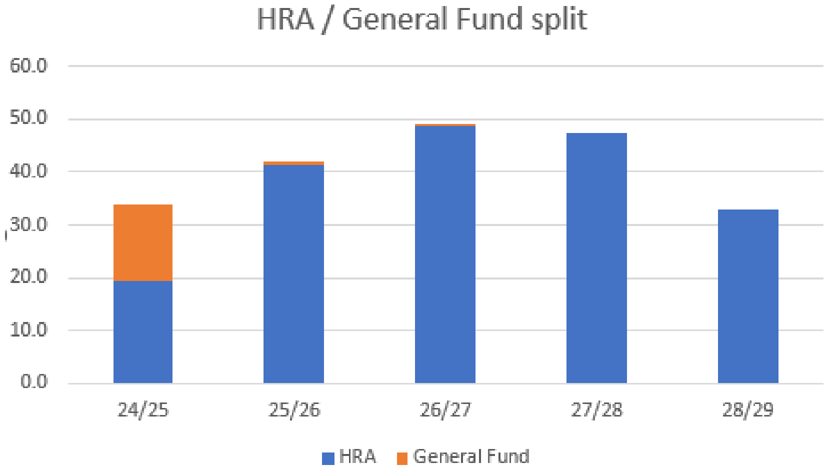
Purpose of the Report

The purpose of this report is to summarise the Treasury Management position for the period to 30th September 2024 and the potential implications for revenue budgets.

In addition, Appendix A to this paper 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 24/25 to 28/29 totals £702m**	As at 30th September 2024, the approved capital budget, for the period from 2023/24 through to 2028/29 totals £702m (a full breakdown is shown in Appendix A). Budget for this period was £797m, there is some slippage in the programme but the main reduction results from changes to the HRA spend in the later years of the forecast
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 with HRA forming the majority of expenditure: - 
1.4	**29% of capital expenditure will be financed by borrowing up to the end of 28/29**	The proportion of this investment funded by prudential borrowing over this period will be £205m. On this basis, approximately 29% of the capital expenditure planned for the next four years is being funded by Prudential Borrowing. After 2024/25 almost all borrowing will be related to HRA expenditure.
1.5	**Graph - Prudential borrowing over next 5 years**	The following graph shows how borrowing varies over the five years. HRA borrowing (£190m) 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.



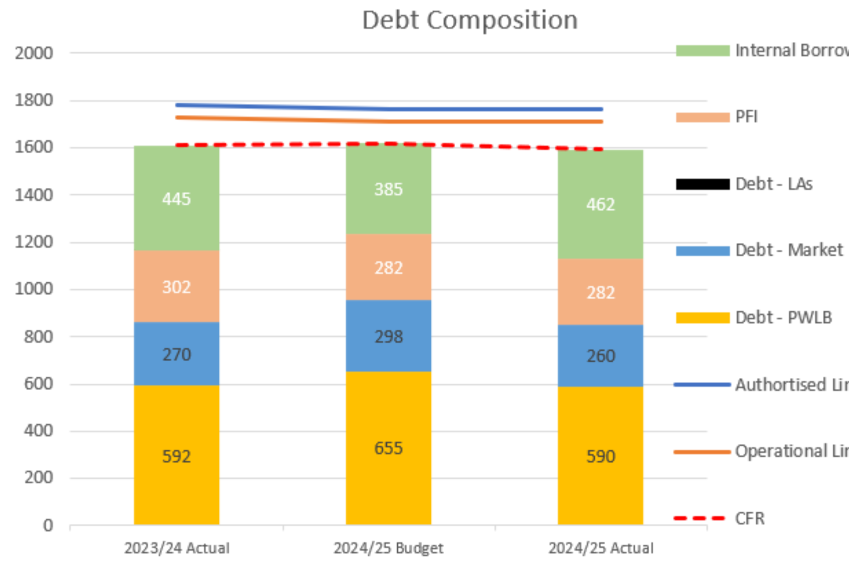
1.6	**Disposal of HoTC II assets are expected to be delayed. Borrowing costs and MRP will continue at current levels during this period**	Anticipated disposals of Blocks in the Heart of the City development are now expected to be delayed until more favourable economic conditions help maximise the benefit 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 24/25. Borrowing rates are currently high and volatile. Internal resources can delay borrowing until more favourable conditions return.**	Economics conditions in the first half of the year have seen the cost of borrowing remain stable, with longer term forecast expecting the rate to drop gradually. 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 24/25 forecast for activity financed by borrowing was externalised at current interest rates of around 5%, this would see an additional (fully year cost) of around £1.7m. While not in the period covered by this report, the first Labour budget in Oct 24 has seen a material increase to borrowing costs, it is unclear if this will be a temporary reaction from the markets.
1.8	**Capital Expenditure funded by new borrowing is forecast to be £6m Lower than budgeted.**	The latest projected capital expenditure estimates for 2024/25 compared to the original budget position shows that Prudential Borrowing is £6m lower than budgeted. Within this HRA borrowing is down by £10m as expenditure is financed by other means. General fund shows an increase of £4m due to slippage from previous years.
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 is forecast to reduce by £15m as the minimum revenue provision (MRP) is higher than expenditure financed by borrowing this year.
- 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 £462m by 31st March 2025.
- 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 24 onwards. Avoiding this is expected to save in the region on £500k. The latest new borrowing was £10m taken in March 24, primarily to cover the repayment of a £10m LOBO loan.
- 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 £60m 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 2024/25.

So far this financial year: -

- £12m of loans will be repaid during 24/25
- 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 a lower capital investment programme with a reduced borrowing requirement. Borrowing is unlikely to be needed until 25/26 at the earliest.

2.3 No rescheduling of our borrowing has been undertaken

No rescheduling of any of our borrowing has been undertaken. Options to repay a £14.5m LOBO loan is 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.

3. Update on Investments

3.1 Investment balances have been stable since Mar 24 and returns are consistently beating the UK Base rate.

	Mth End Balance (£M)	24/25 Average Return	23/24 Average return%
April Actual	£225.7	5.31%	3.85%
May Actual	£223.3	5.31%	3.97%
June Actual	£232.2	5.32%	4.25%
July Actual	£261.0	5.32%	4.75%
Aug Actual	£234.9	5.19%	5.00%
Sept Actual	£221.4	5.23%	5.10%
YTD Ave	£233.1	5.28%	4.49%

Investment balances have remained in line with expectations in the first half of the year. Rates of return haven't fallen as fast as expected and are significantly higher than 12 months ago. Expectations are that rates are now past their peak so average returns will continue to decrease in the second half of the year as older (higher returning) investments mature.

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 returns will diminish as BOE decrease base rates following normalisation of inflation. Borrowing costs have remained stable 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 in line with budget.

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 balanced though risks persist

As at September 2024	Forecast £m	Budget £m	Variance £m
Investment Income (GF only)	-8.2	-8	-0.2
Interest Costs (Excluding HRA)	25.5	25.5	0.0
MRP Costs	21.7	21.5	0.2
Budget Variances	**39.0**	**39.0**	**0.0**

The above table shows:

- Costs are forecast in line with budget as a result of:
  - The budget still balances although there are still significant uncertainties. Interest rates and Liquidity will remain uncertain and the amount of Interest earnt attributable to the HRA will depend on the accuracy of their capital forecasts.
  - MRP costs have risen by around £6m as accounting adjustments made to MRP expired in 24/25.

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	2024/25	2025/26	2026/27
Finance Costs (net)	£42,170	£45,902	£45,714
Net Revenue	£587,800	£599,556	£611,547
Ratio	7.2%	7.7%	7.5%

* *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:

- While not in the table above the financing cost for 23/24 was 5.8% so 24/25 has seen a significant increase.
- 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 which is netted off above is also expected to be around £3m lower than in 23/24

- Financing costs are expected to peak next year as MRP costs increase and income is forecast at reduced levels.
- 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 2024/25 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 2024/25.

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 September 24	2024/25 Forecast £m	2024/25 Budget £m	2024/25 Variance £m
Non-Housing Expenditure	112.2	77.3	34.9
Housing Expenditure	51.6	104.8	-53.2
Total	**163.8**	**182.1**	**-18.3**
Financed by:			
Capital Receipts	17.0	9.5	7.5
Capital Grants and Contributions	92.3	77.1	15.2
Revenue Contributions	20.5	55.5	-35.0
Prudential Borrowing	34.0	40.0	-6.0
Total	**163.8**	**182.1**	**-18.3**

Breakdown of Capital Expenditure

Capital Expenditure	**24/25**	**25/26**	**26/27**	**27/28**	**28/29**
ADULT HEALTH & SOCIAL CARE	5.8	0.0	0.0	0.0	0.0
COMMUNITIES, PARKS & LEISURE	5.9	1.1	0.5	0.5	0.5
ECONOMIC DEVELOPMENT & SKILLS	2.8	0.0	0.0	0.0	0.0
EDUCATION, CHILDREN & FAMILIES	15.4	3.4	0.0	0.0	0.0
HOUSING	51.6	114.0	137.3	119.5	108.3
STRATEGY & RESOURCES	4.5	4.6	0.0	0.0	0.0
TRANSPORT, REGEN & CLIMATE	77.3	49.5	0.0	0.0	0.0
WASTE & STREET SCENE	0.5	0.0	0.0	0.0	0.0
TOTAL	**163.8**	**172.5**	**137.7**	**120.0**	**108.8**

Movement in Capital Financing Requirement

Capital Financing Requirement (CFR)	**Per TMSS 24/25**	**Mid-Year Forecast £m**
CFR - General Fund CFR	1,234.0	1,230.0
CFR - Housing Revenue Account	440.0	364.0
TOTAL	1,674.0	1594.0
Borrowing	960.0	850.4
Other Long-Term Liabilities	302.0	302.0
Forecast - Total Debt as at 31 March 2022	**1,262.0**	**1,152.4**

Appendix 3 – 2024/25 Q2 Revenue Implications of Treasury

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	1,674	1,594
Headroom to Operational Boundary (CFR)	76	156
Headroom to Authorised Borrowing Limit (CFR)	106	186
Projected External Debt at 31 March 2022	1,262	1,152
Headroom to Operational Boundary (debt)	488	598
Headroom to Authorised Borrowing Limit (Debt)	518	628

Interest Rate Forecast

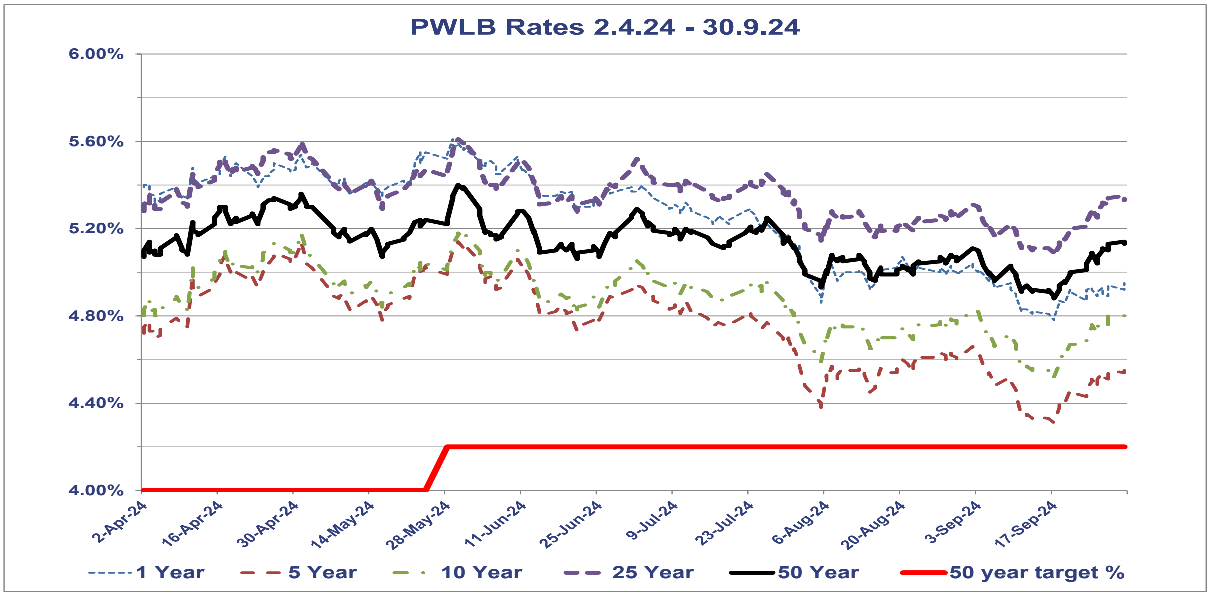
The Council's treasury advisor, Link Asset Services, has provided the following forecast.

The long term forecast for for borrowing rates is to reduce steadily. However, PWLB 25 year has already touched 5.2% in October 24 as markets responded to the Governments budget. 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	28.05.24									
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

PWLB

PWLB Rates have risen from historic lows over the last few years. So far during 2024/25 borrowing rates have seen small variances but been stable. The UK base rate is expected to be cut slowly and expectations for the future are that rates will fall slowly too. There are local and global factors that could increase gilts such as escalations in several ongoing conflicts.



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