SOUTH YORKSHIRE MAYORAL COMBINED AUTHORITY

2021/22 Treasury Management Outturn Report

Investment strategy

The investment strategy agreed at the start of the 2021/22 financial year was to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the MCA's risk appetite.

The MCA has continued with its existing prudent approach to managing its investment portfolio. This entails investing in a relatively narrow range of financial instruments with highly rated counterparties, namely:

- Fixed term deposits with local authorities through the local authority to local authority market
- Call accounts with reputable banks with a high credit rating, and
- Low volatility low risk highly liquid Money Market Funds which provide for instant access.

The MCA Group follows statutory DLUHC investment guidance and CIPFA recommended good practice in placing a high priority on the prudent management of risk by prioritising security and liquidity over maximising returns.

Expected return on Investments.

The expected return on investments at the time that the 2021/22 Treasury Management strategy was agreed was 0.7%, the rationale being that over the course of 2020/21 in the 10 months to January 2021, the average size of the investment portfolio was £260m with the weighted average return on investments falling from 1.07% in April 2020 to 0.50% in January 2021 and averaging 0.70% for the 10 months to date.

Back in January 2021 when the 2021/22 treasury management strategy was written, no increase in the Bank of England base rate was expected over the next three years as economic recovery was expected to be only gradual and, therefore, prolonged.

The landscape has completely transformed since then, as the Bank of England has sought to curb inflation via a series of hikes in the base rate. The latest information from our treasury advisors is that the target performance for relatively short term investments of three months' duration is now as follows:

Average earnings in each year	
2022/23	2.20%
2023/24	2.75%
2024/25	2.30%
2025/26	2.10%
Years 6 to 10	2.00%
Years 10+	2.25%

This represents a significant improvement in the position reported in the mid year report (0.43%) as there is now a clear direction of travel in terms of the Monetary Policy Committee's strategy to meet its target for the rate of inflation.

Current investment portfolio

The MCA Group has continued to hold a substantial investment portfolio throughout the 2021/22 financial year.

As illustrated below, core funds have increased from £304.5m at the end of March 2021 to £371.8m at the end of March 2022.

The increase in core funds is primarily of a temporary nature reflecting the inflow of funding relating to Gainshare, Getting Building Fund, Transforming Cities Funding, South Yorkshire transport capital funding and other grants which have not yet been defrayed.

Longer term investments of more than 365 days

Whilst much of the increase in core funds is of a temporary nature, some of them are longer term, principally those relating to funds being built up to repay MCA Group debt as it falls due.

This allows some of the investment portfolio to be invested longer term which has helped secure much better returns than those available on short duration investments.

The table below summarises the current level of longer term investment instruments in absolute terms and as a percentage of the total investment portfolio as at the end of March 2022.

Long Term Investments	2021/22 Budget £'000	2021/22 Outturn £'000
Maximum sum	£80,000	£80,000
Existing long term investments	£63,000	£40,000
Balance available to invest	£17,000	£40,000
Total investment portfolio (Long Term and Short term)	£369,131	£371,766
Long Term Investments as a % of total investment portfolio	**17%**	**11%**

All of the longer term investments are fixed term deposits held with local authorities.

Overall return on investments

Performance against the target return on the investment portfolio as a whole set in the Treasury Management Strategy is as follows:

Returns on investments	2021/22 Budget %	2021/22 Outturn %
Target return on treasury investments	0.7	0.62

Whilst performance for the year is less than the target set at the start of the year, it is nevertheless still considerably higher than the revised target for 2020/21 of 0.1% suggested by the MCA's treasury advisors. This has been achieved because of the significantly higher returns being earned on longer term investments (c.1.05%) compared to short term investments (c.0.57%).

Security

The 2021/22 Treasury Management Strategy did not permit any relaxation of the criteria for investing with counterparties (duration and type of investment) in order to progress the diversification of the portfolio outside the current narrow range of investment types.

By continuing with the existing prudent approach to managing the investment portfolio, the risk of default in respect of the current narrow range of investment types is considered to be very low (potential default risk is assumed to be zero on local authority deposits and estimated to be c. 0.012% in respect of reputable banks with a high credit rating based on historic default rates).

Liquidity

The 2021/22 Treasury Management Strategy stated that a balance of £25m should be maintained in highly liquid instant access investments / the bank in order to manage day to day treasury activity. This relatively high balance is considered necessary given the uncertainty of the timing of expenditure on the MCA’s major capital investment programmes.

The £25m minimum threshold has been maintained throughout the year to date.

Borrowing Strategy

At the time of approval in March 2021, the 2021/22 borrowing strategy related solely to the transport functions of the MCA pending powers being granted to enable borrowing to be taken out in respect of its wider functions. On 23 March 2022, the Combined Authority (Borrowing Powers) Regulations 2022 came in to force, thus conferring on the South Yorkshire Mayoral Combined Authority the same borrowing powers as its constituent member authorities.

The current borrowing strategy is to meet any borrowing need for the year internally from treasury investments rather than taking out external borrowing. This is in the expectation that the cost of new borrowing will continue to exceed likely investment returns.

The Government provides loans to local authorities via the Public Works Loan Board (PWLB). At the end of March 2022, PWLB rates were in the range of 1.91% for loans of 1 year rising to 2.64% for 25 year borrowing. However, as noted in the section above on investment strategy, the average return on short duration investments was 0.57%. Hence, the strategy agreed at the start of the financial year still remains valid and is likely to remain so for the short to medium term at least.

In addition, the current strategy is to repay debt as it falls due rather than to refinance debt. This assumption has been built into the financial plans resulting in a projected fall in debt servicing costs as debt is repaid.

The strategy also seeks to take the opportunity to reschedule existing debt where this will lead to a net benefit. However, for the reasons described further on in this report it is considered very unlikely that any such opportunities will arise.

Capital Financing Requirement (CFR) estimates vs actual

The tables below show: (1) planned vs actual capital expenditure by thematic area, and (2) how capital expenditure was expected to be financed at the start of the financial year and the outturn position at the end of the year.

1. Group Capital Expenditure Estimates	2021/22 Budget £'000	2021/22 Outturn £'000	Variance £'000
Business Growth & Recovery	£3,406	£9,491	£6,085
Skills & Employment	£3,451	£1,756	-£1,695
Transport & Environment	£147,368	£57,345	-£90,023
Housing & Infrastructure	£67,170	£25,351	-£41,819
MCA Executive / Other	£5,273	£194	-£5,079
Total Capital Investment	**£226,668**	**£94,136**	**-£132,532**

2. Capital Financing Requirement Estimates	2021/22 Budget £'000	2021/22 Outturn £'000
Government Grants	£215,176	£82,118
Capital Receipts	£11,412	£12,018
Earmarked reserves / Revenue contributions	£0	£0
Net borrowing needed for the year	**£80**	**£0**

Any capital expenditure not funded by capital grants, capital receipts, or revenue contributions, results in a need for borrowing. No such need arose when closing the accounts for 2021/22.

The change in the underlying need to borrow or Capital Financing Requirement (CFR) in 2021/22 reflects the continued commitment to setting aside money to pay down legacy debt:

Group Capital Financing Requirement	2021/22 Estimate £'000	2021/22 Outturn £'000
Opening CFR	£117,114	£108,806
Movement in CFR		
Additional borrowing requirement	£80	£4,401
MRP	-£3,860	-£3,367
Capital receipts set aside for repayment of debt	£0	£0
Other adjustments	£0	£0
Closing CFR	**£113,334**	**£109,840**

There are two factors why the closing CFR at 31 March 2022 was lower than previously forecast at the time the 2021/22 Treasury Management Strategy was agreed prior to the start of the 2021/22 financial year:

- Firstly, the MCA took advantage of capital financing flexibilities to fund two capital schemes from grant instead of borrowing in 2020/21 (£3.970m Re-railing and £0.472m BDR capital pot). At outturn the funding has been reversed so that the borrowing requirement of £4.442m deferred from 2021/22 has fallen on 2021/22. This has been offset by a minor adjustment of £0.041m to utilise unallocated accruals.

- Secondly, capital resources of £3.600m were applied to write down the CFR at the end of 2020/21. This was undertaken as part of the Group Reserves Strategy to establish a Project

Feasibility Fund of £3.6m for the early stage development of capital projects. This was done by means of a transfer from the levy reduction reserve with the annual MRP savings arising from the £3.600m of capital receipts / capital grant applied to write down the CFR being used to build the levy reduction reserve back up over a period of time. In 2021/22, the annual MRP savings generated were £0.479m, which is why the MRP for the year is lower than the initial estimate of £3.860m.

Amount of external debt against the Capital Financing Requirement (CFR)

The purpose of this indicator is to assess the extent to which borrowing is only being used in the medium to longer term to finance capital expenditure.

Group external borrowing	2021/22 Estimate £'000	2021/22 Outturn £'000
External Debt		
-MCA Loans	£25,000	£25,000
-Expected change in MCA Loans	£0	£0
-SYPTE Debt	£108,375	£108,375
-Expected change in SYPTE Loans	-£7,975	-£7,975
Gross Debt	**£125,400**	**£125,400**
The Capital Financing Requirement	£113,334	£109,840
Debt in excess of CFR	**£12,066**	**£15,560**

The benchmark recommended by CIPFA is that the estimated amount of gross debt should not exceed the estimated CFR for the current and following two years.

Gross debt is higher than the CFR due to a misalignment in the pace at which the MCA has set money aside to repay debt and the timing of loans falling due for repayment. Over the last three decades the MCA has each year set money aside to allow it to repay loans as they fall due into the future. This has reduced the CFR and meant that cash balances have risen.

This situation is now starting to rebalance as debt matures and significant loan repayments are being made, such as the £53m of payments in 2020/21. By way of comparison, the amount by which debt exceeded CFR is 2019/20 was £71m, and £24.5m in 2020/21.

Further substantial loan repayments will be made as debt matures as illustrated in the table below. This will bring gross debt below the CFR.

Maturity of borrowing:	Amount £'000	%
2022/23	£8,000	6%
2023/24	£50,400	40%
2024/25	£4,000	3%
2025/26	£4,000	3%
2026/27	£4,000	3%
2027/28	£22,000	18%
2028/29	£0	0%
2029/30	£4,000	3%
2030/31	£4,000	3%
2043 to 2056	£25,000	20%
Total	**£125,400**	**100%**

Debt Rescheduling / Early Repayment

The interest rates on the existing debt portfolio range from 4.25% to 8.50%.

The interest rates for premature repayment which might facilitate rescheduling or early repayment of existing debt are in the range 0.3% to 1.1%.

The differential between the rates on the existing debt portfolio and premature repayments determine what premium would be incurred from rescheduling or repaying debt early.

The size of the differential at present means that cost of premature repayment will far outweigh any potential gain. There is therefore little realistic prospect of repaying PWLB debt early in the current environment.

The prospect of refinancing or paying off early some of the underlying PFI debt relating to Doncaster Interchange in order to reduce future unitary payments over the remainder of the PFI term is discussed at the regular review meetings with the PFI Operator. No such opportunities have presented themselves to date.

Borrowing limits

There are two indicators on borrowing limits: the authorised limit and operational boundary.

The authorised limit represents a control on the maximum amount of debt that can be borrowed for capital investment and temporary cash flow purposes. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the long term. The authorised limit allows £40m headroom over the maximum expected amount of gross debt in the year.

The operational boundary is the maximum amount of money that the MCA group expects to borrow during the financial year. It acts as a useful warning if breached during the year that underlying spend may be higher than expected or income lower than budgeted. The operational boundary allows for £56.6m headroom.

Authorised Limit	2021/22 Estimate £'000	2021/22 Outturn £'000
Loans	£673,500	£211,000
Other Long Term Liabilities	£11,000	£11,000
Total	**£684,500**	**£222,000**

Operational Boundary	2021/22 Estimate £'000	2021/22 Outturn £'000
Loans	£658,500	£171,000
Other Long Term Liabilities	£11,000	£11,000
Total	**£669,500**	**£182,000**

The amount of external debt fell from £133.375m at the beginning of 2021/22 to £125.400m at the end of the financial year 2021/22.

There has been no temporary revenue borrowing over the course of the year.

The PFI liability fell by £0.268m from £10.773m at the beginning of the year to £10.505m at the end of 2021/22.

Accordingly, throughout the year, borrowing has remained well within the Authorised Limit and Operational Boundary approved at the start of the year.

Financing Costs

The affordability of decisions taken to finance capital investment is assessed by the ratio of Financing Costs to Net Revenue Stream.

As illustrated below, net financing costs as a function of the transport levy continue to fall. It represents a marked reduction against the comparative figure for 2019/20 of 25.8% due to interest savings of £3.6m being made as a consequence of £53m of debt being repaid in 2020/21.

Ratio of financing costs to net revenue streams	2021/22 Estimate £'000	2021/22 Outturn £'000
Interest	£8,359	£8,325
MRP	£3,859	£3,367
Less Investment Income	-£870	-£1,100
Net Financing Costs	**£11,348**	**£10,592**
Income - transport levy	£54,364	£54,364
Finance Costs/Unrestricted Revenue Income %	20.87%	19.48%

Managing exposure to the risk of interest rate changes

Borrowing

The MCA Group's debt portfolio at the end of 2021/22 comprises the following:

Gross Debt	2021/22 Actual £'000	2021/22 Actual %
Fixed rate PWLB	105,400	78%
Market loans	20,000	15%
Doncaster PFI	10,505	8%
Total	**135,905**	**100%**

All of the PWLB debt is fixed rate. As such there is no risk to the amount of interest payable from interest rate fluctuations. The interest payable is therefore a function of the maturity profile and future interest can be forecast accurately.

The £20m of market loans include an option for the lender to change the interest rate periodically on specified call dates, typically every 6 months. As the interest rates currently being paid on these loans range from 4.50% to 4.95% it seems most unlikely in the current low interest rate environment that the option will be exercised. Future interest can therefore be forecast with a good degree of certainty.

Investments

The table overleaf shows the analysis of investments by investment type at the end of 2021/22.

Investments by investment type	2021/22 Actual £'000	2021/22 Actual %
Fixed term local authority deposits - long term	40,000	11%
Fixed term local authority deposits - short term	110,000	30%
Call accounts	60,000	16%
Money Market Funds - Low Volatility	161,766	44%
Total investments	**371,766**	**100%**

The majority of the MCA's investments are held in Money Market Funds (MMFs). MMFs, although technically equity instruments, are treated as cash equivalents as they are instant access, very low risk funds with a high credit rating which are subject to only minimal risk of price fluctuation.

In due course, the strategy is to move a greater proportion of the MCA's cash into other types of investment the returns being offered on MMFs are relatively low, although they are now starting to increase in line with the Bank of England base rate.

This strategy is however somewhat complicated to implement due to the fact that the local authority to local authority market for short term deposits has been subdued due to the amount of Government funding being pumped into local authorities to support their response to Covid. This situation has begun to change, and we are now seeing improved rates being offered on local authority deposits of long duration, in some cases over 2.0%.

All investments made during the course of the year have been in accordance with the investment Strategy and counterparty criteria specified at the start of the year in the 2020/21 Treasury Management Strategy.