Appendix A

South Yorkshire Mayoral Combined Authority

2022/23 mid-year treasury management review

The following report sets out the Authority's performance as at Budget Revision 2 against the targets set in the 2022/23 treasury management strategy approved by the MCA Board in March 2022.

Investment strategy

Given the risks and uncertainties in the current economic climate, the Authority's focus will continue to be on maximising returns from traditional types of investment rather than on diversification.

This approach is consistent with the MCA's investment priorities which are: security first, portfolio liquidity second and then yield (return). The MCA will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the MCA's risk appetite.

Investment Performance

The MCA's treasury advisors Link Group periodically produce interest rate forecasts. The most recent forecast was produced on 27 September 2022, 5 days after the Bank Rate was increased from 1.75% to 2.25%.

The previous interest rate forecasts were produced by Link on 9 August 2022. Table 1 below shows a significant shift in the advisors' view of future rate rises, as indicated by the figures in the dark orange row entitled 'Change'.

As shown in the forecast table below, the Bank Rate is expected to increase from the current level of 2.25% announced on 22 September 2022 to 5.00% by March 2023 as the Bank of England takes action to counter the threat of inflation. During this period, economic recovery is expected to be only gradual and, therefore, prolonged.

Based on forecast rates in December 2022, returns on investments are therefore expected to improve, at or below 4.7% on investments of shorter duration and at 5.3% on investments of 12 months.

PWLB interest rates on borrowing are expected to rise to around 4.8% to 5.1%, depending on the term of the loan, by December 2022, before falling to between 3.1% and 3.4% over the next three years.

Table 1 - Prospects for interest rates

Comparison of forecasts for Bank Rate today v. previous forecast

Bank Rate	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
27.09.22	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
09.08.22	2.50	2.75	2.75	2.75	2.50	2.50	2.25	2.25	2.25	2.25	2.25	2.00
Change	1.50	2.25	2.25	2.25	2.00	1.50	1.50	1.00	0.75	0.50	0.50	0.50

Overall return on investments

Forecast outturn performance against the target return on the investment portfolio as a whole set in the Treasury Management Strategy is as follows as at Mid Year:

Table 2 – Overall returns on investments

Returns on investments	2022/23 Indicator	2022/23 Mid Year
	%	%
Target return on treasury investments	0.70	1.52

The weighted average return on investments forecast outturn performance is 0.82% above the target set at the start of the year.

We expect the target return to be exceeded further by year-end because the Bank Rate will continue to rise as per Link Group's projections, and this in turn will push up rates on short term investments which comprise the lion's share of all investments, as can be seen in Table 3 below.

Table 3 – Return on investments split between short- and long-term

	2022/23 Mid Year £'000
L T investments	103,000
S T investments	362,686
All investments	**465,686**
L T investments return	1.39%
S T investments return	1.56%
All investments – weighted average	**1.52%**

In spite of the rapid rise in the Bank Rate, the returns on short term investments have remained low throughout the period, for instance 1% on notice accounts, 1.25% on Money Market Funds, and around 0.74% for fixed term deposits. This is because the significant changes to the Bank Rate only took place towards the end of the second quarter (0.5% in August and 0.75% in September) and therefore the increases will impact on our MMF's and notice accounts in the last 6 months of 2022/23.

However, after taking advice from the MCA's treasury advisors, officers have also taken proactive steps to improve yield without compromising on the principles of security and liquidity. For example, the MCA will soon withdraw its investments from two notice accounts which will improve the rate of return from 1% currently to up to 4% based on the latest projections for December 2022.

Returns on long term investments are currently forecast to outturn at 1.39%, but this is on track to improve. For instance, £22m of investments which had been offered at an average rate of 0.26% several years ago (when the Bank Rate was at 0.1%) matured in October and have been re-invested at 4%.

In conclusion, returns are projected to exceed the budgeted treasury investment income for the year by £4m.

Investment portfolio

The MCA Group has continued to hold a substantial investment portfolio throughout the first half of 2022/23.

At the start of the 2022/23 financial year, the investment portfolio stood at £371.8m and has remained at or above this level throughout the first 6 months rising to £465.7m at the end of September 2022. The change is represented by an increase in short term investments of £30.9m and an increase in long term investments of £63m.

The increase in the size of the portfolio is due to the inflow of major funding streams which have been received in advance of delivery. These include, for example, 2022/23 Gainshare allocation, devolved Adult Education Budget funding, Brownfield Housing, and City Region Sustainable Transport Settlement capital funding which has not yet been defrayed.

Investment portfolio by type of investment

Table 4 - Analysis of investments by type as at Period 6

Investments by type	Mid Year Actual £'000	Mid Year Actual %
Fixed term local authority deposits - long term	103,000	22%
Fixed term local authority deposits – short term	57,000	12%
Fixed term bank deposits - short term	40,000	9%
Call accounts	60,000	13%
Money Market Funds	205,686	44%
Total investments	**465,686**	**100%**

The investment strategy of investing in a relatively narrow range of financial instruments with highly rated counterparties in order to maximise security during the pandemic, together with the depressed state of the local authority to local authority market due to Central Government

support for local government to support the response to Covid, has limited opportunities to diversify out of Money Market Funds.

It is worth noting that the Money Market Funds, 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.

By keeping nearly half of the MCA's investments in instant access accounts, this gives officers sufficient flexibility to take advantage of high yield offers for short term investments which exceed the current Bank Rate, as opposed to the opportunity cost of being tied into long term investments which may soon fall behind the rapidly increasing Bank Rate.

Longer term investments of more than 365 days

The table below summarises the current level of longer-term investment instruments against the maximum limit approved in the 2022/23 Treasury Management Strategy.

As at the end of September 2022, there were fixed term deposits with a duration of more than 365 days of £103m. A further £63m of long-term investments have made in the course of the first half of 2022/23, still leaving £47m of headroom.

Table 5 – Investments greater than 365 days

Investment greater than 365 days	2021/22 Outturn £m	2022/23 Estimate £m	2022/23 Mid Year £m
Maximum - end of the year	£80	£150	£150
Existing long-term investments	£40	£40	£103
Balance available to invest	**£40**	**£110**	**£47**

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

Security

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 was estimated to be c. 0.012% in respect of reputable banks with a high credit rating based on historic default rates.

This is considered an acceptable level of risk against an investment portfolio of £465.7m as at the 30th September 2022.

Liquidity

The 2022/23 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 and major initiatives that the MCA is responsible for delivering.

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

Borrowing Strategy

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.

By way of example, the latest fixed term PWLB rates forecast for December 2022 as per the Link Group range from 5.0% for ‘short term’ borrowing (5 years) rising to 5.1% for 20-year borrowing falling back to 4.8% for 50 year borrowing.

By comparison, returns on relatively short-term investments of three to twelve months duration are forecast to decrease from a range of around 4.5% - 5.3% in December 2022 to 4.0% - 4.2% by the end of 2023/24. Accordingly, the differential between borrowing rates and returns on investment remains such that the cost of borrowing remains higher than returns on investments.

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 medium-term financial strategy, resulting in a projected fall in debt servicing costs as debt is repaid.

The borrowing strategy also seeks to take the opportunity to reschedule existing debt where this will lead to an overall saving. However, for the reasons described further on in this report it is considered unlikely that any such opportunities will arise in the short to medium term.

Lending arrangements introduced in November 2020 tightened the rules governing access to PWLB borrowing. The new rules do not allow access to PWLB where a local authority intends to buy commercial investment assets held primarily or partially to generate a profit for yield within its capital plans at any point in the next three years regardless of whether the transaction would notionally be financed from a source other than PWLB. The definition of commercial investment assets in this case is that contained within MHCLG Statutory Guidance on Local Government investments and includes, for example, investment property portfolios whose main purpose is to generate a profit.

The MCA Group’s investment property portfolio is a legacy of bus deregulation and comprises former transport assets which are not being actively managed to achieve commercial returns. Accordingly, they are not considered to fall within the definition of commercial investment assets under the Statutory Guidance. This will however be kept under review should there be any plans to expand or diversify the portfolio.

Capital Financing Requirement (CFR) estimates

The table overleaf shows that as at the end of Period 6, there is no change in forecast for the MCA Group’s underlying need to borrow (Capital Financing Requirement).

Table 6 – Capital Financing Requirement

Group Capital Financing Requirement	2021/22	2022/23	2022/23
	Outturn	Estimate	Mid Year
	£m	£m	£m
Opening CFR	**£109**	**£110**	**£110**
Movement in CFR			
Additional borrowing requirement	£4*	£0	£0
(*deferred due to use of GBF in 2020/21)			
MRP	-£3	-£3	-£3
Capital receipts set aside for the repayment of debt	£0	£0	£0
Other adjustments	£0	£0	£0
Closing CFR	**£110**	**£107**	**£107**

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.

Table 7 – Group external borrowing

Group external borrowing	2021/22	2022/23	2022/23
	Outturn	Estimate	Mid Year
	£m	£m	£m
MCA Loans	£25	£25	£25
Expected change in MCA Loans	£0	£0	£0
SYPTE Debt	£108	£100	£100
Expected change in SYPTE Debt	-£8	-£8	-£8
Gross Debt	**£125**	**£117**	**£117**
Capital Financing Requirement	£110	£107	£107
Debt in excess of CFR	**£16**	**£11**	**£11**

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.

The Group's gross debt is in excess of CFR due to the fact that historic debt taken out in the 1990s has only recently started to fall due for repayment whereas over the same period MRP has been charged annually to the transport levy to write down the CFR.

This situation is now starting to rebalance as debt matures and significant loan repayments are being made. Further substantial loan repayments will be made thereafter as debt matures as illustrated in the table below. This will bring gross debt below the CFR.

Table 8 – Maturity of Group borrowing

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

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.

Table 9 – Authorised limit

Authorised Limit	2021/22	2022/23	2022/23
	Outturn	Estimate	Mid Year
	£m	£m	£m
Loans	£673	£665	£665
Other Long-Term Liabilities	£11	£11	£11

Total	**£684**	**£676**	**£676**

The Other Long-Term Liabilities figure set out in the table above represents the PFI liability in respect of Doncaster Interchange.

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.

Table 10 – Operational boundary

Operational Boundary	**2021/22**	**2022/23**	**2022/23**
	Outturn	**Estimate**	**Mid-Year**
	£m	**£m**	**£m**
Loans	£658	£650	£650
Other Long-Term Liabilities	£11	£11	£11
Total	**£669**	**£661**	**£661**

Both the Authorised Limit and Operational Boundary allow for up to a £500m increase in borrowing capacity to accelerate delivery of the Gainshare funded Investment Programme by bringing forward all uncommitted Gainshare capital that the MCA is due to receive in years 3 to 30 so that it can be invested upfront in the near term. The figure of £500m represents the upper limit of what is potentially affordable to enable the associated debt financing costs to be contained within the overall 30-year Gainshare allocation. It will also be subject to the borrowing cap that the MCA agrees on an annual basis with HM Treasury and DLUHC for non-transport purposes.

In addition, the authorised limit allows for an additional £40m headroom over the maximum expected amount of gross debt in 2022/23 (excluding the £500m referred to above) - the operational boundary allows for an additional £25m headroom. The headroom provides capacity for short term temporary borrowing to manage the MCA's cash position rather than having to realise higher yield longer term investments early before they are due to mature.

The MCA has ready access to temporary borrowing should the need arise through local authority to local authority lending. Currently, borrowing rates in the local authority to local authority market are around 4% for 1-2 year borrowing. In this context, having headroom of up to £40m is considered affordable in the short term. However, no temporary revenue borrowing has been necessary or is anticipated.

The amount of external debt is scheduled to reduce to £117m by the end of the financial year. Hence, borrowing is well within the revised Authorised Limit and Operational Boundary based on the proposed debt cap, and no difficulties are foreseen in remaining within these limits.

Debt Rescheduling / Early Repayment

Opportunities for debt rescheduling depend on the difference between the repayment rates on early redemption and the interest rates on existing debt.

Where repayment rates on early redemption are lower, a premium (cost) is payable. Where repayment rates are higher, a discount (saving) can be obtained.

Even in the present environment of rising interest rates, PWLB rates for early repayment are still significantly lower than rates on the Group's existing PWLB debt portfolio which range from 4.25% to 8.50%. Early repayment would therefore incur a very substantial premium.

The interest rates on the Group's market loans range from 4.50% to 4.95%. As these are considerably higher than the prevailing rates it is considered unlikely that the lender would exercise their call option which would trigger an opportunity to repay the debt early and refinance it by cheaper PWLB debt.

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.

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, the Mid-Year forecast shows a significant reduction in net financing costs due to the surplus investment income generated through the rising Bank Rate and additional cash held on deposit. Financing costs as a percentage to net revenue income is therefore 8% lower than at the time that 2022/23 Treasury Management strategy was set.

Table 11 – Financing Costs

Ratio of financing costs to net revenue streams	2021/22 Outturn £m	2022/23 Estimate £m	2022/23 Mid-Year £m
Interest	£8	£8	£8
MRP	£3	£3	£3
Less Investment Income	-£1	-£1	-£5
Net Financing Costs	**£11**	**£11**	**£6**
Income - transport levy	£54	£54	£54
Finance Costs/Unrestricted Revenue Income %	20%	20%	12%

Managing Exposure to the Risk of Interest Rate Changes

Borrowing

The MCA Group's debt portfolio as at Period 6 comprises the following:

Gross Debt	2022/23 Mid-Year £m	2022/23 Mid-Year %
Fixed Rate PWLB	105	78%
Market Loans	20	15%
Doncaster PFI	11	8%

Total	**136**	**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 unlikely in the current interest rate environment that the option will be exercised. However, we will monitor this carefully as the Bank Rate continues to rise.