Appendix 2

SOUTH YORKSHIRE MAYORAL COMBINED AUTHORITY

2022/23 Treasury Management Outturn Report

Investment strategy

The investment strategy agreed at the start of the 2022/23 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 2022/23 Treasury Management strategy was agreed was 0.7% which was unchanged from the forecast for 2021/22.

The 2022/23 TMS strategy was initially approved at a time when the base rate was 0.5% and it wasn't expected, at that time, that rates would continue to increase in the way they have. As such, it was decided to remain cautious and keep the 2022/23 target largely in line with the prevailing base rate at the time and also in line with the 2021/22 target.

The landscape has completely transformed since then, as the Bank of England has sought to curb inflation via a series of successive hikes in the base rate. The latest base rate rise to 4.5% in May 2023 is the 12th successive rate increase and clearly changes the focus on the target performance for investment returns during 2023/24 onwards.

Current investment portfolio

The MCA Group has continued to hold a substantial investment portfolio throughout the 2022/23 financial year.

As illustrated below, core funds have increased from £372m at the end of March 2022 to £440m at the end of March 2023.

The MCA's investment portfolio is largely shaped by the timing of funds received (largely grant from Government) and the pace of expenditure.

Whilst the MCA achieved record levels of capital and revenue investment during the year it did not meet forecast expenditure profiles. Accordingly, slipping capital expenditure and unexpected underspends on revenue activity led to higher cash balances.

This position is largely temporary. In time slipped activity will catch-up and cash balances will begin to fall. The investment portfolio has been reviewed throughout the year to ensure that the length over which investments are placed matches – as far as is possible – medium-term expenditure forecasts, particularly related to the capital programme.

These reviews have allowed for a reshaping of the portfolio during the year, with more investments placed over a longer term than had been the case at the start of the year.

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, but also including cash related to investment activity that is profiled into the future.

This allows some of the investment portfolio to be invested longer term where yields are currently stronger. This 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 2023.

Long Term Investments	2022/23 Budget £'000	2022/23 Outturn £'000
Maximum sum	£150,000	£150,000
Existing long term investments	£40,000	£123,000
Balance available to invest	£110,000	£27,000
Total investment portfolio (Long Term and Short term)	£371,766	£439,766
Long Term Investments as a % of total investment portfolio	**11%**	**28%**

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	2022/23 Budget %	2022/23 Outturn %
Target return on treasury investments	0.7	1.88

As base rates have increased, actual performance has substantially increased and is significantly above the target. The performance largely reflects the movement in base rates from 0.75% at the start of 2022/23 to 4.25% at the end of it.

The outturn % rate is dampened down slightly by the investment portfolio having a significant number of fixed investments that were made before the first base rate rise in December 2021. Whilst these were higher than the prevailing base rates at the time, they are now much lower than the returns we can make. That said, investment income still generated £8.9m in 2022/23 against an initial budget of £0.9m. £4m of the £8m windfall income was set aside to fund cost of living pressures and to extend the period of the £2 fare cap. A further £0.25m was used to offset the unexpected reduction in capacity grant received fromGovernment.

Security

The 2022/23 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. 0.011% in respect of reputable banks with a high credit rating based on historic default rates).

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.

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

Borrowing Strategy

At the time of approval in March 2022, the 2022/23 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 into force, thus conferring on the South Yorkshire Mayoral Combined Authority the same borrowing powers as its constituent member authorities.

However, unlike other constituent member authorities the MCA's ability to borrow is subject to an annual agreement on an aggregated 'debt-cap' with Government. Each year the MCA submits a request to HM Treasury, with that cap reviewed against appropriateness and affordability.

Whilst the MCA has no new plans to borrow for expenditure it has sought a cap that would afford it headroom to take on borrowing if a suitable investment opportunity arose.

The MCA's debt-cap is based on the capital finance requirement (CFR) and for 2023/24 is held at £209m and for 2024/25 £455m. This cap level provides headroom for additional debt of c. £106m in 2023/24 rising to £352m in 2024/25. This headroom is more than sufficient to meet know and potential investment requirements.

In the event of a need for borrowing arising, the current strategy is to meet any 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 2023, average PWLB rates were in the range of 3.57% for loans of 1 year rising to 4.07% for 25 year borrowing. However, as noted in the section above on investment strategy, the average % return on our investments was 1.88%. 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 and this has now become a real prospect as borrowing rates have increased over the past 12 months. This is covered in more detail later on in the report.

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	2022/23 Estimate £'000	2022/23 Outturn £'000	2022/23 Variance £'000
Total Capital Investment	**£289,000**	**£112,481**	**-£176,519**
Government Grants	£274,000	£108,205	-£165,795
Capital Receipts	£14,920	£4,226	-£10,694
Earmarked reserves / Revenue contributions	£0	£0	£0
Net borrowing needed for the year	**£80**	**£50**	**-£30**

Any capital expenditure not funded by capital grants, capital receipts, or revenue contributions, results in a need for borrowing. There was only a very small requirement in 2022/23.

The change in the underlying need to borrow or Capital Financing Requirement (CFR) in 2022/23 reflects the continued commitment to setting aside money to pay down legacy debt:

2. Group Capital Financing Requirement	2022/23 Estimate £'000	2022/23 Outturn £'000
Opening CFR	£109,439	£109,840
movement in CFR		
Additional borrowing requirement	£80	£50
MRP	-£3,381	-£3,368
Capital receipts set aside for the repayment of debt	£0	£0
Other adjustments	£0	£0
Closing CFR	**£106,138**	**£106,522**

The small requirement for borrowing relates to legacy local transport projects that are now completed.

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	2022/23	2022/23	2022/23	2022/23

	Estimate Loans £'000	Estimate OLTL £'000	Outturn Loans £'000	Outturn OLTL £'000
External Debt				
-MCA Loans	£25,000		£25,000	
-Expected change in MCA Loans	£0		£0	
-SYPTE Debt	£100,400		£100,400	
-Expected change in SYPTE Loans	-£8,000		-£8,000	
Doncaster Interchange PFI		£10,773		£10,773
-Expected change in PFI liability		-£268		-£268
Gross Debt	**£117,400**	**£10,505**	**£117,400**	**£10,505**
The Capital Financing Requirement	£106,138	£10,505	£106,522	£10,505
Debt in excess of CFR	**£11,262**	**£0**	**£10,878**	**£0**

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 historical 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 £8m of payments in 2022/23. By way of comparison, the amount by which debt exceeded CFR in 2019/20 was £71m compared to £11m as at 2022/23 as outlined in the above table.

Further substantial loan repayments will be made as debt matures as illustrated in the table below. This will bring gross debt below the CFR, indicating that the MCA will be in an ‘under-borrowed’ position. This simply means that the MCA’s level of debt will be higher than its debt instruments, such as loans and finance leases.

To bridge the gap the MCA will need to use internal cash balances, such as that which arises from receiving grant cash in advance of need. This approach will mean that the MCA will generate less investment income, but is a cheaper option than taking on new loans.

Maturity of borrowing:	Amount £'000	%
2023/24	£50,400	42%
2024/25	£4,000	4%
2025/26	£4,000	4%
2026/27	£4,000	4%
2027/28	£22,000	18%
2028/29	£0	0%
2029/30	£4,000	4%
2030/31	£4,000	4%
2043 to 2056	£25,000	20%
Total	**£117,400**	**100%**

<u>Debt Rescheduling / Early Repayment</u>

The interest rates on the existing debt portfolio range from 4.25% to 6.50%.

The interest rates for premature repayment - which might facilitate rescheduling or early repayment of existing debt - are in the range 3.7% to 4.2%.

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 has previously meant that cost of premature repayments have far outweighed any potential gain. However, the rates outlined in the previous paragraph, are now much closer to our portfolio range and give rise to a more realistic prospect that early debt repayment may be financially beneficial. As such, it is intended to review our position during the course of 2023/24.

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 but will continue to be reviewed over the next 12 months.

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 £15m 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.

Authorised Limit	2022/23 Estimate £'000	2022/23 Outturn £'000
Loans	£665,000	£665,000
Other Long Term Liabilities	£11,000	£11,000
Total	**£676,000**	**£676,000**

Operational Boundary	2022/23 Estimate £'000	2022/23 Outturn £'000
Loans	£650,000	£650,000
Other Long Term Liabilities	£11,000	£11,000
Total	**£661,000**	**£661,000**

The amount of external debt fell from £125.400m at the beginning of 2021/22 to £117.400m at the end of the financial year 2022/23.

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 2022/23.

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 the MCA's debt portfolio currently only relates to its local transport authority functions it chooses to show this ratio as the cost of financing as percentage of the transport levy.

As illustrated below, net financing costs as a function of the transport levy continue to fall. The net financing cost of 19.4% represents a marked reduction against the comparative figure for 2019/20 of 25.8% as debt is repaid most notably £53m in 2020/21.

Ratio of financing costs to net revenue streams	2022/23 Estimate £'000	2022/23 Outturn £'000
Interest	£7,966	£7,913
MRP	£3,381	£3,368
Less Investment Income	-£715	-£715
Net Financing Costs	**£10,632**	**£10,566**
Income - transport levy	£54,365	£54,365
Finance Costs/Unrestricted Revenue Income %	19.6%	19.4%

Managing exposure to the risk of interest rate changes

Borrowing

The MCA Group's debt portfolio at the end of 2022/23 comprises the following:

Gross Debt	2022/23 Actual £'000	2022/23 Actual %
Fixed rate PWLB	97,400	76%
Market loans	20,000	16%
Doncaster PFI	10,505	8%
Total	**127,905**	**100%**

The totality of gross debt is shown in the table above, including Doncaster PFI.

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. The lender would be likely to increase the rates on these loans if the existing coupon was below the rate at which loans were being extended in the market at that point. As the interest rates currently being paid on these loans range from 4.50% to 4.95% there is an increasing chance that the lender may seek to raise rates as interest rates increase.

Should the lender choose to increase the rates on these loans the MCA will have an option to reject the increase and repay the loans. In the event of this happening the MCA will need to either refinance those repayments with another lender or use internal cash balances at the expense of investment income. This will continue to be monitored.

Investments

The table overleaf shows the analysis of investments by investment type at the end of 2022/23.

Investments by investment type	**2022/23 Actual £'000**	**2022/23 Actual %**
Fixed term local authority deposits - long term	123,000	28%
Fixed term local authority deposits - short term	162,000	37%
Call accounts	40,000	9%
Money Market Funds - Low Volatility	114,766	26%
Total investments	**439,766**	**100%**

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 2022/23 Treasury Management Strategy.

The majority of the MCA's investments are held in local authority deposits. The 65% held in local authority deposits is much higher than the percentage held in 2021/22 and reflects the existing strategy to move a greater proportion of the MCA's cash away from MMFs to secure better rates of return whilst maintaining the same level of security.

Money Market Funds (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. Whilst MMFs tend to offer lower rates of return although they do usually catch up with the Bank of England base rate after a lead in time.