Capital Expenditure Plans and Prudential Indicators: 2019/20

Indicator 1 - Capital expenditure estimates

Capital Expenditure	2019/20 Budget £'000	2019/20 Outturn £'000
South Yorkshire Transport Programmes	£43,430	£38,247
Local Growth Fund	£35,458	£36,147
Corporate	£0	£0
Total Expenditure	**£78,888**	**£74,394**

The figures for the South Yorkshire transport programme comprise the capital expenditure for which the MCA is accountable together with SYPTE's capital programme. The actual expenditure on the South Yorkshire transport capital programme of £38.247m is as reported to the MCA on 1 June 2020 in the 2019/20 outturn report.

The MCA succeeded in exceeding the target level of expenditure required to fully utilise the 2019/20 LGF grant allocation of £29.868m plus 2018/19 carry forward of £5.591m.

Indicator 2 – Capital Financing Requirement (CFR) estimates

The table below shows how the planned capital expenditure is expected to be financed. Any capital expenditure not funded by capital grants, capital receipts, or revenue contributions, results in a need for borrowing.

Capital Expenditure	2019/20 Budget £'000	2019/20 Outturn £'000
South Yorkshire Transport Programmes	£43,430	£37,119
Local Growth Fund	£35,458	£36,147
Corporate	£0	£0
Total Expenditure	**£78,888**	**£73,266**

Transport Programme Financed by:		
Capital Receipts	£0	£1,464
Capital Grants	£34,395	£29,485
Other Contributions	£0	£0
Net borrowing needed for the year	**£9,035**	**£6,170**

Local Growth Fund Programme Financed by:		
Capital Receipts	£0	£0
Capital Grants	£35,458	£36,147
Other Contributions	£0	£0
Net borrowing needed for the year	**£0**	**£0**

The borrowing requirement stems from the decision taken in 2018/19 to borrow up to £23.3m over the 3 year period 2018/19 to 2020/21 (in respect of Rotherham Interchange, re-railing and the BDR pot). The actual borrowing requirement in 2018/19 was £12.087m, with a further estimated borrowing requirement of £6.170m in 2019/20 and £4.707m in 2020/21. The aggregate borrowing requirement over the 3 year period of £22.964m is therefore within the overall borrowing requirement approved in 2018/19.

The MCA's overall forecast underlying need to borrow or Capital Financing Requirement (CFR) at the end of 2019/20 is now £116.646m as illustrated in the table below:

Capital Financing Requirement (CFR)	2019/20	2019/20
	Estimate	Actual
	£'000	£'000
Opening CFR	£111,212	£113,045
Movement in CFR	**£5,840**	**£3,009**
Movement in CFR represented by:		
- Expenditure not funded by grants, receipts or contributions	£9,035	£6,170
- MRP/VMRP and other movements	-£3,195	-£3,161
Closing CFR	**£117,052**	**£116,054**

NB: note that the above figures relate to the MCA itself. SYPTE have capital financing requirements in addition to these figures – principally the PFI arrangement relating to Doncaster Interchange.

Indicator 3 - 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.

CURRENT BORROWING POSITION	2019/20	2019/20
	Estimate	Actual
	£'000	£'000
External Debt		
-CA Loans at 1st April	£25,660	£25,660
-Expected change in CA Loans	£0	£0
-PTE Debt at 1st April	£161,375	£161,375
-Expected change in PTE Loans	£0	£0
Gross debt	**£187,035**	**£187,035**
The Capital Financing Requirement (CFR)	£117,052	£116,054
Debt in excess of CFR	**-£69,983**	**-£70,981**

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 reason why gross debt is substantially in excess of CFR for the MCA Group is a legacy of previous capital financing regulations that applied to PTEs which required amounts set aside for the repayment of debt to be held in cash. This is one of the reasons for the high level of treasury investments held by the MCA as illustrated in Indicator 8.

The excess is forecast to unwind in the medium term as debt matures and is repaid. For example, £53m of debt is due to be repaid in 2020/21 and a further £62.4m over the period 2021/22 to 2023/24.

Indicator 4 - Ratio of Financing Costs to Net Revenue Stream

This indicator is a measure of the affordability of decisions taken to finance capital investment borrowing in the context of an authority's overall financial sustainability.

As the MCA currently has powers to borrow in relation to its transport functions, the information given in the table relates solely to transport.

Ratio of financing costs to net revenue streams - transport	2019/20 Estimate £'000	2019/20 Actual £'000
Interest payable	£13,136	£13,154
MRP	£3,195	£3,161
Less Investment Income	-£1,910	-£2,308
Total Financing Costs	**£14,421**	**£14,007**
Income – transport levy	£54,365	£54,365
Finance Costs as a percentage of Unrestricted Revenue Income	26.5%	25.8%

As the interest payable is principally fixed rate PWLB borrowing, the amount of interest payable is in effect pre-determined before the start of the financial year as is the transport levy. The only variable is therefore the return on treasury investments.

The ratio is currently relatively high which reflects the fact that a significant proportion of SYPTE's operational budget is required to meet the borrowing costs of its debt portfolio. The ratio will start to reduce significantly as debt is repaid commencing in 2020/21 when external interest payable is expected to fall by £3.6m as a consequence of £53m of debt being repaid.

External Debt

Indicator 5 – authorised limit

The **authorised limit on external debt** represents a control on the maximum amount of debt the MCA Group can borrow for capital investment and temporary cash flow purposes. Under Section 3 of the Local Government Act 2003 this limit is agreed by the MCA and cannot be revised without that body's agreement.

The authorised limit 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.

Authorised Limit	2019/20 Estimate £'000	2019/20 Actual £'000
Loans	£228,500	£228,500
Other Long-Term Liabilities	£11,500	£11,500
Total	**£240,000**	**£240,000**

Indicator 6 – Operational Boundary

The operational boundary is the maximum amount of money 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.

Operational Boundary	2019/20 Estimate £'000	2019/20 Actual £'000
Loans	£213,500	£213,500
Other Long-Term Liabilities	£11,500	£11,500
Total	**£225,000**	**£225,000**

As illustrated under both Indicator 5 Authorised Limit and Indicator 6 operational Boundary, the maximum amount of debt held by the MCA Group during the course of the year is that brought forward at 1 April 2019.

The debt portfolio of £187.035m has remained unchanged throughout the financial year, as no new borrowing was undertaken during the year (the underlying borrowing requirement instead being met internally from treasury investments) and there were no scheduled loan repayments due in the year (there is no possibility to reschedule debt due to the prohibitively high cost of early redemption).

No temporary revenue borrowing has been necessary in 2019/20.

Hence, for the full financial year, the maximum amount of MCA Group external debt has stayed well within the Authorised Limit and operational Boundary approved at the start of the year.

<u>Treasury management</u>

Managing exposure to the risk of interest rate changes

<u>Borrowing</u>

The MCA Group's debt portfolio at 31 March 2020 comprises PWLB fixed rate debt of £166.375m and £20m of market loans where the lender has an option to change the interest rate periodically on specified call dates, typically every 6 months, and £0.660m of other loans.

Given the current historically low interest rate environment, the level of premium payable on redeeming the fixed rate debt is prohibitive to any rescheduling options. Similarly, it is thought unlikely that the lender would exercise the option to change the interest rate on the market loans in the short to medium as rates are forecast to remain significantly below the interest rates currently being paid on these loans which range from 4.50% to 4.95%.

<u>Investments</u>

The investment portfolio predominantly comprises fixed term deposits with local authorities and other low risk counterparties, call accounts and Money Market Funds.

There is a mix of short term and long-term fixed term deposits (£91.0m short term and £45m long term at 31 March 2020). The short-term deposits enable the MCA Group to take advantage of any increase in returns whereas the long-term investments provide the security of a higher return with over the medium term with high quality counterparties. Money Market Funds provide the high liquidity required to manage the MCA Group's cash position on a day to day basis.

Indicator 7 – Maturity structure of borrowing (Refinancing risk)

A refinancing risk arises where an authority intends to refinance debt as it falls due for repayment. This is mitigated by setting limits on the amount that falls due for repayment in any one year to spread the risk of having to refinance loans at a time when terms might be disadvantageous, or interest rates are high.

However, the MCA Group's current financial strategy is to repay debt as it falls due rather than to refinance debt. It is therefore not exposed to refinancing risk as such.

Nevertheless, it is helpful to understand the maturity profile of the MCA Group's debt insofar as it impacts on the Group's longer-term finances.

Hence, the table below indicates when the MCA Group's debt is scheduled to be repaid expressed in terms of the MCA Group's borrowing at the start of 2019/20 but excluding Doncaster PFI.

	2019/20 estimate		2019/20 Forecast		2019/20 estimate		2019/20 Forecast	
Maturity of borrowing:	**Fixed Rate Borrowing**		**Fixed Rate Borrowing**		**Variable Rate Borrowing**		**Variable Rate Borrowing**	
	Lower	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**	**Lower**	**Upper**
Under 12 months	0%	5%	0%	0%	0%	100%	0%	0%
12 months to 2 years	0%	35%	0%	32%	0%	0%	0%	0%
2 years to five years	0%	40%	0%	40%	0%	0%	0%	0%
5 years to 10 years	0%	20%	0%	20%	0%	0%	0%	0%
10 years to 20 years	0%	5%	0%	5%	0%	0%	0%	0%
20 years to 30 years	0%	0%	0%	0%	0%	0%	0%	15%
30 years to 40 years	0%	3%	0%	3%	0%	0%	0%	85%

There has been no change to the MCA Group's debt portfolio or maturity profile since the start of the year.

As noted above, the substantial differential in interest rates between the historic rate at which loans were taken out (which range from 4.25% to 8.75%) and the current very low interest rates for premature repayment (currently in the range 0.7% to 2% for PWLB depending on the length of the loan) means that it will continue to be prohibitively expensive to repay loans early due to the substantial premiums this would incur. Accordingly, the assumption remains that all fixed rate loans will be repaid as they mature.

No loan repayments were scheduled in 2019/20. However, £53m of fixed rate PWLB debt is due to be repaid in 2020/21 (hence the upper limit for 12 months to 2 years being 32%) and a further £62.4m of fixed rate PWLB debt in the period 2021/22 to 2023/24 (hence the upper limit for 2 years to 5 years being 40%)

The variable rate borrowing figures in the table represent the £20m of market loans held by SYPTE where the lender has an option to change the interest rate periodically on specified call dates. Under CIPFA's Code of Practice on treasury Management these are classified as variable where they are in their call period. However, as noted above, in the current low interest rate environment it is considered unlikely that these call options will be exercised.

Investment strategy / performance

The MCA Group follows statutory MHCLG 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.

These principles are applied in practice by:

- Only investing with highly creditworthy counterparties
- Defining the types of investment instrument, the MCA Group can invest in between high security and high liquidity specified investments of up to 1 year with high credit quality counterparties and non-specified investments of higher risk that which need to be managed and monitored more closely, and
- A limit on longer term investments invested for more than 365 days

This strategy has been adhered to during the full financial year, as investments have been restricted to:

- Deposits with local authorities
- Call accounts with reputable banks with a high credit rating, and
- Money Market Funds.

Money Market Funds are highly liquid which can be withdrawn at very short notice and assist in managing the cash position on a day to day basis. The MCA's Money Market Funds are instant access very low risk with a high credit rating.

All the longer-term investments held by the MCA Group are fixed term deposits placed with local authorities in South Yorkshire (see Indicator 9).

The table shows the analysis of investments by investment type at 31 March 2020

Investments by investment type	31.3.2020	31.3.2020
	Actual	Actual
	£'000	%
Fixed term local authority deposits - long term	76,000	34.95
Call accounts	60,000	27.59
Money Market Funds	81,471	37.46
Total investments	**217,471**	**100**

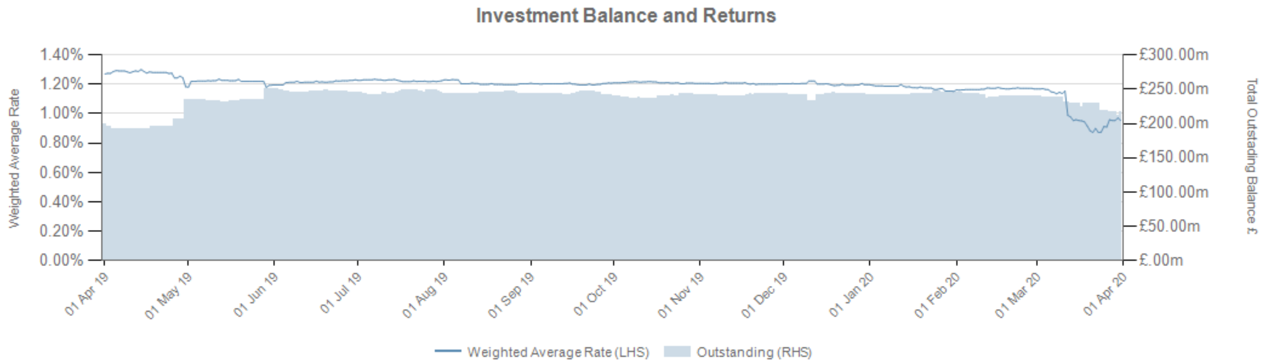
Rate of return on investments (Yield)

Indicator 8 – Target return on treasury investments

Returns on investments	2019/20	2019/20
	Estimate	Actual
	%	%
Target return on treasury investments	1.45	1.19

The target returns on treasury investments approved at the start of the year of 1.45% assumed that there would be a slow but gradual increase in returns on shorter term investments to 1.25% on average over the course of the year. This in turn was contingent on there being a slow but gradual increase in the Bank of England base rate from 0.75% at the start of the year to 1% in June 2019 to 1.25% in March 2020.

The actual average return on investments earned in the 12 months to March 2020 was 1.19%. This is illustrated in more detail, together with the level of investment balances held, in the graph below. The investment balances comprise the short and longer term investments relating to the MCA Group's transport related functions and the short term investments relating to the MCA / LEP's economic development functions.



Indicator 9 - Liquidity: Funds invested for greater than 365 days

Long term cashflow projections are used to determine the maximum amount of treasury investments that can be held longer term for periods of more than 365 days.

Longer term investments tend to attract higher returns than short term investments and can therefore improve the overall return. For example, as noted above under Indicator 8, the average return on the £45m of long-term investments currently held by the MCA of 2.1% compares favourably to the average return on short term investments of 0.9%. However, they need to be managed within the overall risk appetite of the Authority and to ensure there is sufficient cash in the long term as, for example, debt repayments fall due.

All the longer-term investments held currently are with secure counterparties (local authorities within South Yorkshire). The balance of £45m is within maximum level of long-term investments approved in the 2019/20 treasury strategy of £90m illustrated in the table below.

The level of long-term investments and range of counterparties they can be placed with has been reviewed in setting the 2020/21 strategy.

Investment greater than 365 days	2019/20 Estimate £'000	2019/20 Actual £'000
Maximum sums	£90,000	£90,000