Appendix 3

SHEFFIELD CITY REGION MAYORAL COMBINED AUTHORITY

2020/21 Treasury Management Outturn Report

Investment strategy

The investment strategy agreed at the start of the 2020/21 financial year set out the intention to look at options to diversify the investment portfolio in view of the availability of core funds over the longer term to seek better returns on investments, whilst paying due regard to security, liquidity and yield.

This was before the advent of the Coronavirus pandemic.

The greatly increased uncertainty this has brought about has meant that, for the time being at least, 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 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.

Expected return on Investments.

The expected return on investments at the time that the 2020/21 Treasury Management strategy was agreed were as follows:

Average earnings in each year	
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%

The landscape has completely transformed since and the latest information from our treasury advisors is that the target performance for relatively short term investments of three months' duration is as follows:

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.25%
2024/25	0.50%

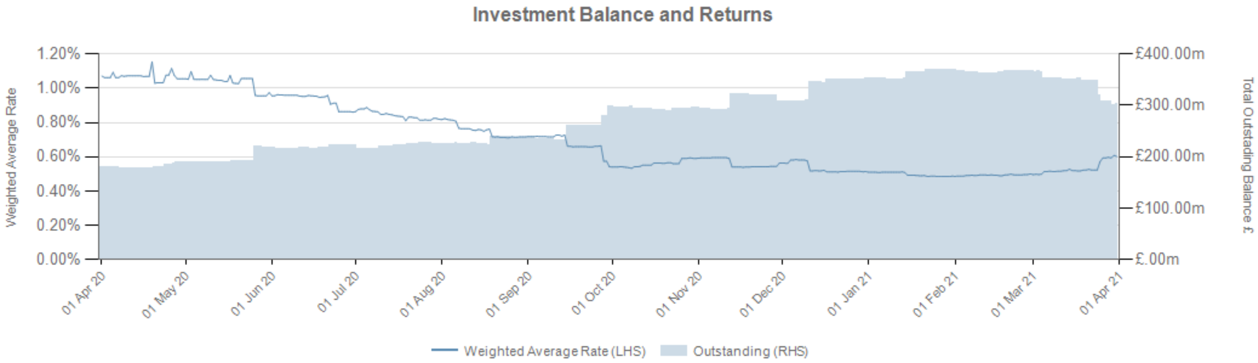
This represents a slight improvement in the position reported in the mid year report as there is now a suggestion that the stronger and quicker UK recovery may result in an increase in Bank of England Base Rate from 0.10% to 0.25% in Q3 2023 - sooner than previously anticipated. However, it does reaffirm that we are likely to be in a low interest environment for some time to come.

Current investment portfolio

The MCA Group has continued to hold a substantial investment portfolio throughout the 2020/21 financial year.

As illustrated below, core funds have increased from £217m at the end of March 2020 to £304.5m at the end of March 2021.

The increase in core funds is primarily of a temporary nature reflecting the inflow of funding relating to LGF, Gainshare, Getting Building Fund, Transforming Cities Funding, South Yorkshire transport capital funding which has 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 2021.

Long Term Investments	**2020/21 Budget £'000**	**2020/21 Outturn £'000**
Maximum sum	£113,400	£113,400
Existing long term investments	£60,000	£78,000
Balance available to invest	£53,400	£35,400
Total investment portfolio (Long Term and Short term)	£151,200	£304,558
Long Term Investments as a % of total investment portfolio	**75%**	**26%**

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	2020/21 Budget %	2020/21 Outturn %
Target return on treasury investments	1.4	0.66

Whilst performance for the year to date 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 as illustrated in the table below. The table shows the weighted average return on investments on a quarterly basis together with the weighted average level of investments:

	2020/21			
	Q1	Q2	Period 8	Q4
	£'000	£'000	£'000	£'000
L T investments	65,000	60,000	75,000	88,000
S T investments	133,760	174,885	226,547	268,321
All investments - weighted average	**198,760**	**234,885**	**301,547**	**356,231**
L T investments return	2.16%	2.16%	1.86%	1.65%
S T investments return	0.45%	0.27%	0.13%	0.13%
All investments – weighted average	**1.01%**	**0.75%**	**0.56%**	**0.51%**

Security

The 2020/21 Treasury Management Strategy permitted in principle that there be a limited 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.

The continuation of the existing prudent approach to managing the investment portfolio has meant it has not been necessary to consider introducing such a relaxation to date.

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 2020/21 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 (for example the £42.5m Additional Restrictions Grant received during the year to provide support to businesses whose activity has been curtailed temporarily due to the Covid 19 pandemic).

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

Borrowing Strategy

The borrowing strategy currently relates 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.

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.

On 26 November 2020 the Government introduced changes to the terms under which it provides Public Works Loan Board (PWLB) loans to local authorities. This resulted in a 1% cut in the interest rate payable on new loans taken out with effect from 26 November onwards. This has meant that, where previously, PWLB rates were in the range of 2% for loans of 1 year rising to 3% for 25 year borrowing, they are now available in the range between 1% and 2.4%.

However, as noted in the section above on investment strategy, there has been a substantial fall in the expected returns on short duration investments to 0.1%

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, whilst ever returns are forecast to stay at the current historic low level of c. 0.1%.

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

The table below shows how planned 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. Capital Expenditure Estimates	**2020/21**	**2020/21**
	Estimate	**Outturn**
	£'000	**£'000**
Local Growth Fund (including Retained Majors)	£42,400	£43,694
Brownfield Fund	£0	£0
Getting Building Fund	£0	£647
Active Travel Emergency Fund (Capital)	£0	£603
Active Travel (Phase-2)	£0	£0
Highways Capital Maintenance	£12,219	£11,241
Pothole & Challenge Fund	£0	£6,210
Integrated Transport Block	£8,428	£6,765
Transforming Cities Fund	£30,400	£5,077
Gainshare Capital	£18,000	£1,194
ICT and Asset Renewals	£0	£207
SYPTE (excluding ITB & TCF)	£9,250	£6,388
BDR Transport Capital Pot	£1,043	£472
Total Capital Investment	**£121,740**	**£82,498**

2. Capital Financing Requirement Estimates	2020/21	2020/21
	Estimate	Outturn
	£'000	£'000
Government Grants	£115,209	£82,981
Capital Receipts	£0	-£483
Earmarked reserves / Revenue contributions	£1,252	£0
Net borrowing needed for the year	**£5,279**	**£0**

Any capital expenditure not funded by capital grants, capital receipts, or revenue contributions, results in a need for borrowing.

The negative financing relating to capital receipts is a consequence of a technical adjustment.

The change in the underlying need to borrow or Capital Financing Requirement (CFR) in 2020/21 reflects the continued commitment to setting aside money to pay down legacy debt:

2. Capital Financing Requirement	2020/21	2020/21
	Budget	Outturn
	£'000	£'000
Opening CFR	£115,603	£116,054
Movement in CFR		
Additional borrowing requirement	£5,279	£0
MRP	-£4,022	-£3,648
Capital receipts set aside for the repayment of debt	£0	-£3,600
Closing CFR	**£116,860**	**£108,806**

The original estimate assumed a borrowing need of £5.279m in 2020/21 to meet planned capital investment of £4.235m for re-railing and £1.043m towards the M1 junction 31 Highways Improvement scheme which Barnsley MBC are funding from their share of the BDR capital pot. The overall borrowing requirement after allowing for the additional borrowing need of £5.279m remained within the overall amount approved by the MCA in 2018/19 to borrow up to £23.3m to support capital investment on South Yorkshire transport schemes (Rotherham Interchange, re-railing and the BDR capital pot).

In the event, flexibilities in capital grant financing have been utilised to meet the capital investment in these two schemes in 2020/21 which amounted to £4.442m. Hence, there is no borrowing requirement this year. However, these same flexibilities will be utilised again next year with the effect that the borrowing requirement will crystallise in 2021/22.

The lower than budgeted charge for MRP is due to a reprofiling of MRP in relation to Rotherham Interchange.

As part of the reserves strategy set out in the main body of the MCA Outturn Report, £3.6m has been transferred from the levy reduction reserve to create a Project Feasibility Fund. In order to restore the amount transferred from the levy reduction reserve, £3.6m of capital resources has been applied to the Capital Financing Requirement which will have the effect of reducing the annual MRP charge. Savings from the reduced MRP charge will then be used to top the levy reduction reserve back up.

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	2020/21 Budget £'000	2020/21 Outturn £'000
External Debt		
-MCA Loans at 1st April	£25,660	£25,000
-Expected change in MCA Loans	£0	£0
-SYPTE Debt at 1st April	£161,375	£161,375
-Expected change in SYPTE Loans	-£53,000	-£53,000
Gross Debt	**£134,035**	**£133,375**
The Capital Financing Requirement	£116,860	£108,806
Debt in excess of CFR	**£17,175**	**£24,569**

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.
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This situation is now starting to rebalance as debt matures and significant loan repayments are being made. This is evidenced in the above table, with the £53m of loan repayable in 2020/21 reducing the amount by which debt exceeds CFR from £71m in 2019/20 to £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	%
2021/22	£7,975	6%
2022/23	£8,000	6%
2023/24	£50,400	38%
2024/25	£4,000	3%
2025/26	£4,000	3%
2026/27	£4,000	3%
2027/28	£22,000	16%
2028/29	£0	0%
2029/30	£4,000	3%
2030/31	£4,000	3%
2043 to 2056	£25,000	19%
Total	**£133,375**	**100%**

Debt Rescheduling / Early Repayment

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

Following the government's introduction of the new lending terms for PWLB, interest rates for new borrowing are currently in the range in the range between 1% and 2.4%. The interest rates for premature repayment which might facilitate rescheduling or early repayment of existing debt are c. 1% lower than this in the range -0.1% to 1.3%.

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 £25m headroom.

Authorised Limit	2020/21 Budget £'000	2020/21 Outturn £'000
Loans	£228,500	£228,500
Other Long Term Liabilities	£11,500	£11,500
Total	**£240,000**	**£240,000**

Operational Boundary	2020/21 Budget £'000	2020/21 Outturn £'000
Loans	£213,500	£213,500
Other Long Term Liabilities	£11,500	£11,500
Total	**£225,000**	**£225,000**

The amount of external debt fell from £187.035m at the beginning of 2020/21 to £133.375m at the end of the financial year.

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

The PFI liability fell by £0.246m from £11.019m at the beginning of the year to £10.773m at the end of 2020/21.

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 have continued 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	2020/21	2020/21
	Budget	Outturn
	£'000	£'000
Interest	£9,541	£9,530
MRP	£4,022	£3,648
Less Investment Income	-£1,274	-£1,520
Net Financing Costs	**£12,289**	**£11,658**
Income - transport levy	£54,365	£54,365
Finance Costs/Unrestricted Revenue Income %	22.6%	21.4%

Managing exposure to the risk of interest rate changes

Borrowing

The MCA Group's debt portfolio at the end of 2020/21 comprises the following :

Gross Debt	2020/21	2020/21
	Actual	Actual
	£'000	%
Fixed rate PWLB	113,375	79%
Market loans	20,000	14%
Doncaster PFI	10,773	7%
Total	**144,148**	**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 shows the analysis of investments by investment type at the end of 2020/21.

Investments by investment type	2020/21 Actual £'000	2020/21 Actual %
Fixed term local authority deposits - long term	78,000	26%
Fixed term local authority deposits - short term	57,000	19%
Call accounts	60,000	20%
Money Market Funds - Low Volatility	109,558	36%
Total investments	**304,558**	**100**

The strategy is to move money out of Money Market Funds into other types of investment as soon as possible as the returns being offered on MMFs are now very low at around 0%.

This strategy is however difficult to implement due to the fact that the local authority to local authority market for fixed term deposits remains very subdued due to the amount of Government funding being pumped into local authorities to support their response to Covid. The rates being offered on local authority deposits of short duration is similarly very low at around 0.1%

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.

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.