Strategy & Programmes Committee

SPT

Annual Treasury Management Report 2023/2024

Date of meeting 6 September 2024 **Date of report** 2 August 2024

Report by Director of Finance & Corporate Support

1. Object of report

To report to the Committee on the treasury management activities and the actual Prudential and Treasury Indicators for financial year 2023/2024.

2. Background to report

SPT is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual report reviewing treasury management activities and the actual Prudential and Treasury Indicators for 2023/2024.

SPT has adopted the CIPFA Treasury Management in The Public Services: Code of Practice and Cross-sectoral Guidance Notes (the "Code of Practice") and fully complies with the requirements of the 2021 Edition.

SPT has adopted the CIPFA Prudential Code for Capital Finance in Local Authorities (the "Prudential Code") and fully complies with the requirements of the 2021 Edition.

The annual treasury management strategy for 2023/2024 was approved by the Partnership on 17 March 2023.
spt.co.uk/media//xjal3pga/p170323_agenda8.pdf

The mid-year treasury update report for 2023/2024 was submitted to the Strategy & Programmes Committee on 24 November 2023.
spt.co.uk/media/cizjxnat/sp241123_agenda6.pdf

3. The Economy in 2023/2024

The UK economy was facing a more positive outlook but the restrictive stance on monetary policy to tackle inflation continued to weigh on activity and momentum. Inflationary pressures have now eased but during 2023/2024 proved more persistent than expected. Unemployment remained at historically low levels but is expected to rise gradually.

Annual economic growth (GDP) was estimated to have risen by 0.1% in 2023 having risen by 4.3% in 2022. The UK economy briefly entered into a technical recession in 2023 Q4 (October to December) following two consecutive quarters of negative growth. However, growth is starting to recover with UK GDP estimated to have risen by 0.7% in 2024 Q1 (January to March) and is expected to be around 0.3% in 2024 Q2 and Q3.

Consumer Price Index (CPI) inflation had continued to fall from 8.7% in April 2023 to 3.2% in March 2024 and reached the 2% MPC target in May 2024. CPI inflation is expected to increase to around 2.75% over the second half of this year, as declines in energy prices last year fell out of the annual comparison, revealing more clearly the prevailing persistence of domestic inflationary pressures. However, domestic inflationary persistence is expected to fade away over the next few years, owing to the restrictive stance of monetary policy. CPI inflation is expected to fall back to 1.7% in two years' time and to 1.5% in three years.

The unemployment rate remained at historically low levels during the financial year, being 3.9% in the three months to April 2023 and 4.3% in the three months to March 2024. The labour market remains tight by historical standards, although there are signs that it has started to loosen. Pay growth pressure has been persistent but there are signs that this is now easing, driven by the normalisation of short-term inflation expectations and some easing in the labour market. The unemployment rate is expected to rise gradually to around 4.6% by 2027 Q3 (July to September).

The Bank of England's Monetary Policy Committee (MPC) seeks to set monetary policy to meet the 2% inflation target, and in a way that helps to sustain economic growth and employment. During 2023/2024, the MPC increased the Bank Rate from 4.25% in April 2023 to 5.25% in August 2023 in response to the elevated inflationary pressures. The Bank Rate has just been reduced to 5% in August 2024 and is expected to continue to fall to 4% by March 2025, as inflationary pressures subside.

The MPC judges that monetary policy will need to continue to remain restrictive until risks to inflation returning sustainably to the 2% target in the medium-term have dissipated further.

4. Capital Expenditure and Financing

SPT undertakes capital expenditure on long-term assets. These activities may either be financed through:

- the application of capital or revenue resources (e.g. capital grants, capital receipts, revenue contributions etc.) which has no resultant impact on borrowing requirement; or
- if insufficient capital or revenue resources are available, or a decision is taken not to apply those resources, the capital expenditure will give rise to a borrowing requirement.

The actual capital expenditure forms one of the required Prudential Indicators. Table 1 below shows the actual capital expenditure over the last three financial years and how this was financed.

Table 1	**2021/2022 Actual £000**	**2022/2023 Actual £000**	**2023/2024 Actual £000**
Capital Programme expenditure	**25,793**	**37,111**	**42,412**
Capital grants and contributions	25,295	35,060	38,539
Transfers from / (to) reserves	498	2,051	3,873
Capital Funding	**25,793**	**37,111**	**42,412**

5. Portfolio position

At the beginning and end of 2023/2024 SPT's treasury investments position was as shown in Table 2 below:

Table 2 Treasury Investments	Principal 31 March 2023 £000	Principal 31 March 2024 £000	Interest Earned £000
Deposits with UK banks and building societies (rated)			
Managed in-house	164,555	186,896	8,857
Managed externally	0	0	0
Total Treasury Investments	**164,555**	**186,896**	**8,857**

All treasury investments mature within one year.

SPT currently holds substantial balances which will be used to fund the Subway Modernisation programme and other future Public Transport initiatives. It is envisaged that the balances will significantly reduce over the coming financial years.

At the beginning and end of 2023/2024 SPT's non-treasury investments position was as shown in Table 3 below:

Table 3 Non-treasury Investments	Valuation 31 March 2023 £000	Valuation 31 March 2024 £000	Income Earned £000
Investment properties	5,675	5,625	619
Shareholdings in joint venture companies	5	5	0
Total Non-treasury Investments	**5,680**	**5,630**	**619**

All non-treasury investments are for longer than one year and are managed in-house.

At the beginning and end of 2023/2024 SPT's debt position was as shown in Table 4 below:

Table 4 External Debt	Principal 31 March 2023 £000	Principal 31 March 2024 £000	Principal Repaid £000	Interest Rate (including expenses) %
Gross borrowing	0	0	0	0

SPT had no requirement for borrowing during 2023/2024 and remains debt free. The current funding and expenditure profiles to 2025/2026 do not require any borrowing.

6. Prudential and Treasury Indicators

The Local Government in Scotland Act 2003 and supporting regulations requires SPT to have regard to the CIPFA Prudential Code and therefore to set Prudential Indicators to ensure that our capital investment plans are affordable, prudent and sustainable.

The CIPFA Code of Practice requires SPT to set out an annual treasury management strategy for borrowing and investment. This includes setting Treasury Indicators to ensure that treasury activities are kept within authorised limits.

During financial year 2023/2024, SPT operated within the Prudential and Treasury Indicators set out in the Treasury Management Strategy 2023/2024.

The Prudential and Treasury Indicators for 2023/2024 are shown in Appendix 1.

7. Annual Investment Strategy

The Annual Investment Strategy for 2023/2024 was approved by the Partnership on 17 March 2023.

Investment Policy
The 2023/2024 Strategy states that "SPT's investment priorities will be security first, liquidity second and then return."

Permitted Investments
The 2023/2024 Strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Credit Rating Criteria
The 2023/2024 Strategy lists the potential institutions permitted to be used by SPT.

SPT applies the service provided by our treasury management advisors, Link Group. This service employs a modelling approach utilising credit ratings from the main credit rating agencies supplemented by additional market data, to classify counterparties into bands which indicate the relative credit rating and suggested duration for investments.

Counterparty Limits
The 2023/2024 Strategy set out counterparty limits as follows:

- Principal Banker - the greater of £50m or 50% of total balances;
- Debt Management Office – 100% of total balances;
- Other Institutions - the greater of £10m or 35% of total balances; and
- To allow for temporary operational circumstances, there is a tolerance level of 2% of the balance held with each counterparty.

Additionally, SPT has set an individual transaction limit of £20m with a tolerance level of 2%.

The Annual Investment Strategy for 2023/2024 was followed in full.

8. Investment Outturn

SPT's investment policy is governed by Scottish Government investment regulations, which have been implemented in the Annual Investment Strategy approved by the Partnership on 17 March 2023.

The result of the Annual Investment Strategy for 2023/2024 is shown in Table 5 below:

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return %	Liquidity
Account 1	1,017	3.37	5.01	Instant Access
Account 2	16,006	3.37	5.01	Instant Access
Account 3	15,695	4.99	5.01	0 Day Notice

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return %	Liquidity
Account 4	3,462	5.20	5.01	Fixed Term
Account 5	1,182	3.50	5.01	Instant Access
Account 6	25,000	5.13	5.01	95 Day Notice
Account 7	20,385	5.09	5.01	Fixed Term
Account 8	30,000	5.39	5.01	Fixed Term
Account 9	104	3.03	5.01	Instant Access
Account 10	2,807	3.96	5.01	35 Day Notice
Account 11	5,403	4.45	5.01	Fixed Term
Account 12	1,177	3.18	5.01	Instant Access
Account 13	1,984	4.64	5.01	31 Day Notice
Account 14	19,818	5.42	5.01	95 Day Notice
Account 15	10,769	4.85	5.01	Fixed Term
Account 16	25,385	5.24	5.01	Fixed Term

* The benchmark return is the backward-looking 7-day compounded SONIA

SPT earned interest of £8.857m during 2023/2024, against a budgeted income of £5.1m. This is an increase of £4.938m when compared to the interest earned of £3.919m during 2022/2023, mainly as a result of the significant increase in investment rates earned in 2023/2024 following the successive increases in the Bank Rate.

The overall average rate of return obtained equates to 4.95% per annum, which is 0.06% per annum below the benchmark.

SPT uses an investment benchmark of backward-looking 7-day compounded SONIA (Sterling Overnight Index Average). SONIA is the risk-free rate for sterling markets administered by the Bank of England. It is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

SPT holds a number of investment accounts with balances below £1,000. This is in order to maintain relationships with counterparties which currently offer low rates of return or do not meet the minimum acceptable credit criteria. Retaining these accounts ensures quick access at the point that these accounts become competitive or regain the minimum acceptable credit criteria. These accounts have not been shown in Table 5 on the basis of materiality.

Investments are placed at available rates at a point in time in accordance with SPT's priorities of security, liquidity and return as well as available counterparty balances whilst taking into account forecast cash flow requirements. Consequently, Table 5 reflects the impact of timing issues in relation to maximising investment returns.

9. Control of Interest Rate Risk

The expectation for interest rates within the 2023/2024 Treasury Management Strategy was that the Bank of England's Monetary Policy Committee (MPC) would continue to increase Bank Rate, from 4.25% in March 2023 to peak at 4.5% by June 2023. Thereafter, to gradually fall back to

4% by March 2024. However, in response to inflationary pressures, the MPC continued to increase Bank Rate to peak at 5.25% in August 2023 where it has remained until August 2024.

This meant that for most of the financial year there was a stepped increase in the investment rates available, although some financial institutions were slower to pass on the changes in Bank Rate to customers and the rates offered reflected the liquidity of the funds held. Rates for fixed term deposits were noticeably higher than for instant access and short-term notice accounts.

While SPT has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

Consequently, SPT has taken a pragmatic approach to investing and, whilst continuing to maintain cash balances for liquidity purposes, value was sought by placing fixed term deposits on a rolling basis.

10. Committee action

The Committee is recommended to:

(i) note the content of this report; and

(ii) note the Prudential and Treasury Indicators for 2023/2024 as detailed in Appendix 1.

11. Consequences

Policy consequences	*None.*
Legal consequences	*All legislation and regulations are adhered to.*
Financial consequences	*As detailed in the report.*
Personnel consequences	*None.*
Equalities consequences	*None.*
Risk consequences	*As detailed in the report.*
Climate Change, Adaptation & Carbon consequences	*None.*

Name	Lesley Aird	**Name**	Valerie Davidson
Title	**Director of Finance & Corporate Support**	**Title**	**Chief Executive**

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Prudential and Treasury Indicators	**2022/2023 Actual £000**	**2023/2024 Forecast** Note (1) **£000**	**2023/2024 Actual £000**
Prudential Indicators			
Capital Expenditure	37,111	52,128	42,412
Capital Financing Requirement (CFR)	0	0	0
Actual External Debt	0	0	0
Operational Boundary for External Debt	50,000	50,000	50,000
Authorised Limit for External Debt	55,000	55,000	55,000
Ratio of financing costs to net revenue stream Note (2)	0%	0%	0%
Ratio of net income from service investments to net revenue stream	2%	1%	2%
Treasury Indicators			
Liability Benchmark Note (3)	(164,555)	(136,906)	(186,896)
Principal sums invested > 365 days Note (4)			
- Actual	0	50,000	0
- Authorised Limit	50,000	50,000	50,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2023/2024.

Note (2) Re-stated to exclude Interest Receivable from the calculation of Financing Costs, as defined in the CIPFA Prudential Code for Capital Finance in Local Authorities 2021 Edition.

Note (3) The Liability Benchmark is calculated as SPT's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned minimum revenue provision and any other major cash flows forecast. Since SPT is currently debt-free, the Liability Benchmark has a negative value, representing the treasury management investments.

Note (4) Investments taken out during the financial year for a period greater than 365 days.