Committee report

Annual Treasury Management Report 2019/20

Committee Strategy & Programmes

Date of meeting 28 August 2020 **Date of report** 18 August 2020

Report by Assistant Chief Executive

1. Object of 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 management indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the "Code of Practice") and the CIPFA Prudential Code for Capital Finance in Local Authorities (the "Prudential Code").

2. Background

SPT has adopted the Code of Practice and fully complies with its requirements.

The primary requirements of the Code of Practice are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of SPT's Treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which SPT will seek to achieve those policies and objectives.
- Receipt by the Partnership of an annual Treasury Management Strategy Statement (including the Annual Investment Strategy) for the year ahead, a Mid-Year Review Report and an Annual Review Report covering activities during the previous year.
- Delegation by SPT of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Treasury management in this context is defined as:

"The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

During financial year 2019/20 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year (Partnership, 8 March 2019)
- a mid-year treasury update report (Strategy & Programmes, 22 November 2019)
- an annual report following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with SPT's policies previously approved by members.

3. The Economy in 2019/20

Economic growth (GDP) was estimated to have increased by 1.5% in calendar year 2019, slightly above the 1.3% growth in 2018 but lower than expected. This reflected weaker global growth, driven by trade protectionism, and the domestic impact of Brexit-related uncertainties. The lockdown measures introduced to protect public health in response to the Covid-19 pandemic in March 2020 restricted economic activity and resulted in a sudden fall in GDP of 6 % in March and around 20% in April. However, there is expected to be a sharp recovery in GDP as the Covid-19 outbreak is brought under control and lockdown measures are relaxed.

Consumer Price Index (CPI) inflation fell from 2.1% in April 2019 to 1.5% in March 2020, having peaked at 2.1% in July 2019. During the financial year, inflation had been kept below the UK Government's 2% target due to the recent appreciation in the value of Sterling and to the temporary effects of falls in regulated energy and water prices. Following the outbreak of the Covid-19 pandemic, oil prices have collapsed and other inflationary pressures have eased. CPI inflation is well below the 2% target and is expected to fall further below it in coming quarters, largely reflecting the weakness of demand.

The unemployment rate remained low throughout the financial year, at 3.8% in the three months to April 2019 and 3.9% in the three months to March 2020, being amongst the lowest levels since 1975. Although wage inflation has eased somewhat, it continued to contribute to domestic inflationary pressures. In response to the Covid-19 pandemic, the Government introduced various schemes to support the employed and self-employed during lockdown. However, average earnings are expected to fall and there is a risk of higher and more persistent unemployment in the UK as a result of the economic impact of the Covid-19 pandemic.

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 2019/20 the MPC maintained Bank Rate at 0.75% whilst it continued to monitor, amongst other factors, the responses of companies and households to Brexit developments as well as the prospects for a recovery in global growth. However, in March 2020 it became clear that the Covid-19 pandemic posed a significant threat to the UK economy. There were two emergency cuts in Bank Rate, firstly at its meeting on 10 March to 0.25% and then at its meeting on 19 March to 0.10%. This was accompanied by an increase in Quantitative Easing of £200 billion and measures to help businesses access loans from their banks. The expectation is that Bank Rate will remain at 0.10% in the near-term.

In this unprecedented situation, the outlook for the UK economy is unusually uncertain. It is dependent upon: the new trading arrangements between the UK and the EU; whether the transition to them is abrupt or smooth; the evolution of the Covid-19 pandemic and the measures taken to protect public health; mounting global trade tensions; and how households, businesses and financial markets respond to these factors.

The MPC will continue to monitor the situation closely and, consistent with its remit, stands ready to take further action as necessary to support the economy and ensure a sustained return of inflation to the 2% target.

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	**2017/18 Actual £000**	**2018/19 Actual £000**	**2019/20 Actual £000**
Capital Programme expenditure	**39,960**	**58,852**	**36,358**
Capital grants and contributions	39,946	58,852	36,383
Revenue contribution to the capital programme	0	0	0
Transfers from / (to) reserves	14	0	(25)
Borrowings	0	0	0
Capital Funding	**39,960**	**58,852**	**36,358**

5. Overall Treasury Position

At the beginning and end of 2019/20 SPT's debt position was as shown in Table 2 below:

Table 2 Debt	**Principal 31 March 2019 £000**	**Principal 31 March 2020 £000**	**Principal Repaid £000**	**Interest Rate (including expenses) %**
Total debt	0	0	0	0

As can be seen from Table 2, SPT is currently debt free, but may need to borrow in future to fund the Subway Modernisation programme for cash flow purposes. However, the current funding and expenditure profiles to 2022/23 do not require any borrowing.

At the beginning and end of 2019/20 SPT's treasury investments position was as shown in Table 3 below:

Table 3 Treasury Investments	**Principal 31 March 2019 £000**	**Principal 31 March 2020 £000**	**Interest Earned £000**
Deposits with UK banks and building societies (rated)	170,519	169,174	1,689

All treasury investments mature within one year and are managed in-house.

As can be seen from Table 3, SPT earned interest of £1.689m during 2019/20. This is an increase of £0.310m when compared to the interest earned of £1.379m during 2018/19, mainly as a result of the increases in the investment rates earned in 2019/20.

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 be significantly reduced over the coming financial years.

At the beginning and end of 2019/20 SPT's non-treasury investments position was as shown in Table 4 below:

Table 4 Non-treasury Investments	**Valuation 31 March 2019 £000**	**Valuation 31 March 2020 £000**	**Income Earned £000**
Investment properties	5,916	5,681	632
Shareholdings in joint venture companies	5	5	0

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

6. Prudential and Treasury Management Indicators

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

SPT has adopted the Code of Practice which requires it to set out an annual treasury management strategy for borrowing and investment. This includes setting Treasury Management Indicators to ensure that treasury activities are kept within authorised limits.

The Prudential and Treasury Management Indicators are shown in Appendix 1.

During financial year 2019/20, SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2019/20, with the exception of the investments taken out during the financial year for a period greater than 365 days.

This Treasury Management Indicator was exceeded in March 2020 when, having regard to security, cashflow requirements and market expectations for interest rates, a 12 month fixed term deposit was placed for £10m. Table 5 below shows the investments comprising the 2019/20 indicator. These were all 12 month fixed term deposits which, due to the settlement dates being extended to fall on a working day and the leap year in 2020, were technically for a duration greater than 365 days.

Table 5 **Principal sums invested for greater than 365 days**			
Placed	**Fixed Term Deposit £000**	**Interest rate**	**Duration (days)**
November 2019	7,000	1.10%	368
January 2020	10,000	1.10%	368
January 2020	10,000	1.10%	367
March 2020	10,000	1.05%	367
2019/20 Indicator	**37,000**		
Authorised Limit	**35,000**		

7. Annual Investment Strategy

The Annual Investment Strategy for 2019/20 was reported to and approved by the Partnership on 8 March 2019.

Investment Policy

The 2019/20 strategy states that “SPT’s investment priorities will be security first, liquidity second and then return.”

Permitted Investments

The 2019/20 strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Creditworthiness

The 2019/20 strategy lists the potential institutions permitted to be used by SPT.

SPT applies the creditworthiness service provided by its external treasury management advisors, Link Asset Services. This service utilises a modelling approach, based on credit rating agency scores supplemented by additional market data, to classify counterparties into bands indicating relative creditworthiness and suggested duration for investments.

Counterparty Limits

The 2019/20 strategy sets out counterparty limits as follows:

- Principal Banker - the greater of £50m or 50% of total balances;
- UK Nationalised and Part Nationalised Banks - the greater of £30m or 30% of total balances;
- Other Institutions - the greater of £10m or 25% of total balances.

To allow for temporary operational circumstances, there is a tolerance level of 2% of the balance held with each counterparty.

The Annual Investment Strategy for 2019/20 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 8 March 2019.

The result of the Annual Investment Strategy for 2019/20 is shown in Table 6 below:

Table 6	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	191	0.55	0.53	Instant Access
Account 2	25,000	0.99	0.53	95 Day Notice
Account 3	14,748	0.78	0.53	Instant Access
Account 4	1,134	0.78	0.53	Instant Access
Account 5	865	0.77	0.53	32 Day Notice
Account 6	33,587	1.10	0.53	95 Day Notice
Account 7	22,077	1.22	0.53	Fixed Term
Account 8	0	0.69	0.53	Instant Access
Account 9	2,310	0.69	0.53	Instant Access
Account 10	2,697	0.85	0.53	31 Day Notice
Account 11	10,604	0.78	0.53	Instant Access
Account 12	25,353	1.05	0.53	95 Day Notice
Account 13	0	0.20	0.53	Instant Access
Account 14	0	0.82	0.53	95 Day Notice
Account 15	4	0.40	0.53	Instant Access
Account 16	4	0.65	0.53	31 Day Notice
Account 17	27,562	1.02	0.53	95 Day Notice

* The benchmark return is the 7 day LIBID uncompounded

The overall average rate of return equates to 1.02%, which exceeds the benchmark by 0.49% per annum.

As can be seen from Table 6, SPT holds a number of investment accounts with low balances. This is in order to maintain relationships with counterparties which currently offer low rates of return or do not meet the minimum acceptable creditworthiness. Retaining these accounts ensures quick access at the point that these accounts become competitive or regain the minimum acceptable creditworthiness.

As can also be seen from Table 6, SPT holds its investment balances with a blend of liquidity in cognisance of cashflow requirements.

9. Control of Interest Rate Risk

Investment returns remained relatively low during 2019/20.

The expectation for interest rates within the 2019/20 Treasury Management Strategy was that the Bank of England's Monetary Policy Committee (MPC) would increase Bank Rate gradually from 0.75% to 1.00% over the course of the financial year, in order to return inflation sustainably to the 2% target.

Market concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer-term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the House of Commons but fell back again in January 2020, before recovering after the UK left the EU on 31 January 2020. When the Covid-19 pandemic started affecting the UK economy in February / March 2020, market rates initially dropped but then rose sharply back up again due to a shortage of liquidity in financial markets.

As longer-term rates were significantly higher than shorter-term rates during the year, value was therefore sought by placing longer-term investments because cash balances were sufficient to allow this.

10. Conclusion

During the financial year 2019/20 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2019/20, with the exception of the investments taken out during the financial year for a period greater than 365 days.

The Annual Investment Strategy for 2019/20 was followed in full. Looking ahead, given the current economic uncertainty it is necessary to continue close monitoring of all SPTs Treasury decisions.

11. Committee action

The Committee is recommended to consider this report and to:

(a) note the content of this report; and

(b) note the prudential and treasury management indicators for 2019/20 as detailed in Appendix 1.

12. 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*

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Title	**Assistant Chief Executive**	**Title**	**Chief Executive**

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Prudential and treasury management indicators	2018/19 Actual £000	2019/20 Forecast £000	2019/20 Actual £000
		Note (1)	
Prudential indicators			
Capital Expenditure	58,852	72,157	36,358
Ratio of financing costs to net revenue stream	-7%	-5%	-2%
Net borrowing requirement / (net investments) Note (2)			
Brought forward 1 April	(168,153)	(148,132)	(170,519)
Carried forward 31 March	(170,519)	(104,303)	(169,174)
In year borrowing requirement	0	0	0
Capital Financing Requirement as at 31 March	0	0	0
Annual change in Capital Financing Requirement	0	0	0
Treasury management indicators			
External debt			
Indicator	0	0	0
Operational Boundary	60,000	50,000	50,000
Authorised Limit	66,000	55,000	55,000
Principal sums invested > 365 days Note (3)			
Indicator	10,000	35,000	37,000
Authorised Limit	25,000	35,000	35,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2019/20.

Note (2) The total of external borrowings less investments held. Since SPT is debt free this indicator represents the investment balances held.

Note (3) Investments taken out during the financial year for a period greater than 365 days.