Committee report

Treasury Management Strategy Statement, Annual Investment Strategy and Capital Strategy 2020/21

Committee Strategy & Programmes

Date of meeting 7 February 2020 **Date of report** 29 January 2020

Report by Assistant Chief Executive

1. Object of report

To update members on treasury management processes and seek approval for the proposed treasury management strategy and annual investment strategy for financial year 2020/21.

To seek approval for the proposed capital strategy which forms part of SPT's integrated revenue, capital and treasury management planning.

2. Background

SPT has adopted the CIPFA Code of Practice on Treasury Management (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 strategy report for the year ahead, a mid-year progress report and an annual review report of 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."

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 seeks approval for the proposed treasury management strategy for the year ahead.

The CIPFA Prudential Code for Capital Finance in Local Authorities (the “Prudential Code”) requires the preparation of a capital strategy, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services.
- an overview of how the associated risk is managed.
- the implications for future financial sustainability.

This report covers:

- the Treasury Management Strategy (the capital plans and how the investments and borrowings are to be organised) including prudential indicators and treasury indicators;
- the Investment Strategy (the parameters on how investments are to be managed); and
- the Capital Strategy.

3. Treasury Management Strategy 2020/21

The strategy for 2020/21 covers two main areas:

- capital issues
    - the capital plans and the associated prudential indicators.
- treasury management issues
    - policy on use of external service providers;
    - the current treasury position;
    - treasury indicators which will limit the treasury risk and activities of SPT;
    - the borrowing strategy;
    - policy on borrowing in advance of need;
    - the investment strategy;
    - creditworthiness policy;
    - economic outlook; and
    - the prospects for interest rates.

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Scottish Government investment regulations.

The Scottish Government draft Budget for 2020/21 would normally have been announced in December 2019, however, this was postponed until February 2020 due to the UK General Election and consequent re-scheduled UK Budget announcement. Therefore, for the purposes of producing the proposed Capital Plan for 2020/21, an assumption has been made that the general grant to SPT will be maintained at £23.1m, the same level as 2019/20. If required, the Capital Plan 2020/21 may need to be updated following the announcement of the Scottish Government draft Budget on 6 February 2020.

Members will be aware that SPT normally prepares an aligned three-year rolling capital programme and budget which seeks to balance the transport project delivery aspirations and the available funding. SPT has again prepared a programme covering the period 2020/21 to 2022/23 but members are advised that in doing so no funding information for years two or three is known at this stage. Therefore, the capital programme and capital funding for 2021/22 and 2022/23 is based on estimates and is indicative only, noting that this will be refined and resubmitted at a later stage when funding information is available.

3.1 Capital Prudential Indicators 2018/19 to 2022/23

SPT's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

3.1.1 Capital expenditure

This prudential indicator is a summary of SPT's capital expenditure plans and how these plans are being funded.

Table 1	**2018/19 Actual £000**	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Capital Expenditure	**58,852**	**65,553**	**64,333**	**57,831**	**34,792**
Capital grants and contributions	58,852	65,553	61,017	57,831	34,792
Other grants and contributions	0	0	50	0	0
Subway fund utilisation	0	0	0	0	0
Transfers from reserves	0	0	3,266	0	0
Borrowings	0	0	0	0	0
Capital Funding	**58,852**	**65,553**	**64,333**	**57,831**	**34,792**

3.1.2 SPT's borrowing need (the Capital Financing Requirement)

The Capital Financing Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of SPT's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

Table 2 Capital Financing Requirement	**2018/19 Actual £000**	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
CFR	0	0	0	0	0
Movement in CFR	0	0	0	0	0

3.1.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (e.g. asset sales). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 3 **Year End Resources**	**2018/19 Actual £000**	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
General Fund Balance	11,169	11,169	11,169	11,169	11,169
Capital Receipts Reserve	25,983	25,983	22,717	22,717	22,717
Capital Grants Unapplied Account *	70,988	28,538	45,805	41,527	29,835
Subway fund	51,283	65,332	75,441	83,495	88,597
Total core funds	**159,423**	**131,022**	**155,132**	**158,908**	**152,318**
Working capital **	11,096	11,096	11,096	11,096	11,096
Expected investments *	**170,519**	**142,118**	**166,228**	**170,004**	**163,414**

** Note - the increase in Capital Grants Unapplied Account and expected investments in 2020/21 and 2021/22 relates to the Scottish Government Specific Grant for Subway Modernisation being received in advance of the revised spend profile. These balances will reduce substantially after 2022/23.*

*** Note - working capital balances shown are estimated year-end, these may be higher mid-year.*

3.1.4 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on SPT's overall finances.

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

Table 4	**2018/19 Actual**	**2019/20 Forecast**	**2020/21 Forecast**	**2021/22 Estimate**	**2022/23 Estimate**
SPT	-7%	-7%	-5%	-5%	-4%

This indicator is dependent on the mix of borrowing / utilisation of the Subway Fund applied in future years.

3.2 Treasury Management

The capital expenditure plans set out above (section 3.1.1) provide details of the service activity of SPT. The treasury management function ensures that SPT's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.2.1 Treasury Management Consultants

SPT uses Link Asset Services as its external treasury management advisors.

SPT recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

SPT also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. SPT will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

3.2.2 Current Portfolio Position

SPT's treasury portfolio position, for both current and forward projections, is summarised in Tables 5 and 6 below.

Table 5 Treasury Investments	**2018/19 Actual £000**	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Banks and building societies (rated)					
Managed in-house	170,519	142,118	166,228*	170,004*	163,414
Managed externally	0	0	0	0	0
Total Investments	**170,519**	**142,118**	**166,228**	**170,004**	**163,414**

** Note - the increase in Investments in 2020/21 and 2021/22 relates to the Scottish Government Specific Grant for Subway Modernisation being received in advance of the revised spend profile.*

Table 6 shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 6 External Debt	**2018/19 Actual £000**	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Gross debt at 1 April	0	0	0	0	0
Expected change in gross debt	0	0	0	0	0
Actual gross debt at 31 March	**0**	**0**	**0**	**0**	**0**
The Capital Financing Requirement	**0**	**0**	**0**	**0**	**0**
Under / (over) borrowing	0	0	0	0	0

Within the prudential indicators there are a number of key indicators to ensure that SPT operates its activities within well-defined limits. One of these is that SPT needs to ensure that its gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

SPT has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

3.2.3 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary: This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 7 Operational Boundary	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Debt	50,000	50,000	50,000	50,000

The Authorised Limit for external borrowing: This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Partnership. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

The authorised limits for external debt for the current year and two subsequent years are the legislative limits determined under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

Table 8 Authorised Limit	**2019/20 Forecast £000**	**2020/21 Forecast £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Debt	55,000	55,000	55,000	55,000

Whilst there are currently no plans to borrow, the Operational Boundary and Authorised Limit have been set to enable SPT to react to any changes in circumstances.

3.2.4 Borrowing Strategy

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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

SPT is currently debt free and has no plans to borrow in 2020/21.

Any changes in circumstances will be reported to the Partnership at the earliest available opportunity.

3.2.5 Policy on Borrowing in Advance of Need

SPT will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that SPT can ensure the security of such funds.

4. Annual Investment Strategy 2020/21

4.1 Investment Policy

SPT's investment policy implements the requirements of the Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010), and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017.

The above regulations and guidance place a high priority on the management of risk. SPT's investment priorities will be security first, liquidity second and then return. SPT has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

1) SPT has defined the list of types of investment instruments that are permitted investments authorised for use in Appendix 1. Appendix 2 expands on the treasury risks involved in each type of investment and the mitigation measures adopted.

2) SPT will set limits on the amounts and maturity of its investments through applying the Creditworthiness Policy (section 4.3) and Counterparty Limits (section 4.4).

3) SPT has determined that it will only use approved counterparties from the United Kingdom.

4) SPT has determined that all investments will be denominated in Sterling.

5) SPT will set a limit for the amount of its investments which are invested for longer than 365 days, as shown in Table 10 in section 4.6 below.

6) SPT has set an individual transaction limit of £20m.

7) SPT has engaged external consultants (section 3.2.1) to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the organisation in the context of the expected level of cash balances and need for liquidity throughout the year.

However, SPT will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

The above criteria are unchanged from last year.

4.2 Permitted Investments

The Investment Regulations (Code on the Investment of Money by Local Authorities) requires the Committee approval of all the types of investments to be used and set appropriate limits for the amount that can be held in each investment type.

SPT has determined that all investments will be denominated in Sterling.

Details of all permitted investments can be found in Appendix 1.

4.3 Creditworthiness Policy

Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

SPT applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by SPT to determine the suggested duration for investments.

SPT will therefore use counterparties within the following durational bands:

Table 9	
Colour code	**Duration (up to)**
Yellow	5 years
Purple	2 years
Blue	1 year (only applies to UK Part Nationalised Banks)
Orange	1 year
Red	6 months
Green	100 days
No Colour	0 days (i.e. not to be used)

SPT has determined that it will only use approved counterparties from the United Kingdom.

A full list of SPT's potential counterparties can be found in Appendix 3.

Credit ratings will be monitored regularly and if a downgrade results in the counterparty no longer meeting SPT's minimum criteria, its further use as a new investment will be withdrawn immediately.

4.4 Counterparty Limits

SPT's counterparty limits are set 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.

Additionally, SPT has set an individual transaction limit of £20m.

4.5 Liquidity Considerations

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

4.6 Investment Treasury Indicator and Limit

The Investment Treasury Indicator and Limit is the total principal funds invested for greater than 365 days. These limits are set with regard to SPT's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Table 10	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
Principal sums invested > 365 days	50,000	50,000	50,000	50,000

4.7 Investment Risk Benchmarking

SPT will use an investment benchmark to assess the investment performance of its investment portfolio of 7-day LIBID uncompounded.

4.8 Investment Activity Reporting

SPT will report on its investment activity as part of its Mid-Year Treasury Management Report and Annual Treasury Management Report.

4.9 Economic Outlook

Economic growth (GDP) was estimated to have risen by 0.6% in 2019 Q1 (January to March); fallen by -0.2% in Q2; risen by 0.4% in Q3; and is expected to rise by 0.1% in Q4. This slowdown in the economy in 2019 mainly reflects weaker global growth, driven by trade protectionism, and the domestic impact of Brexit-related uncertainties. UK GDP growth is expected to recover over 2020, conditioned on an orderly transition to a deep free trade agreement between the United Kingdom and the European Union. The expectation is that four-quarter growth picks up from 1.0% in 2019 Q4; to 1.6% in 2020 Q4; to 1.8% in 2021 Q4; and to 2.1% in 2022 Q4.

The unemployment rate has fallen to 3.8% in November 2019 and although wage inflation has eased somewhat, it continues to contribute to domestic inflationary pressures. Unemployment is expected to rise to 4% in the short-term.

Consumer Price Index (CPI) inflation increased from 1.8% in January 2019 to 2.1% in July 2019, before falling gradually to 1.3% in December 2019. CPI inflation is expected to

continue at this level in the short-term, owing to the recent appreciation in the value of Sterling and to the temporary effects of falls in regulated energy and water prices. However, the expectation is for CPI inflation to rise to 2.0% by 2021 Q4 and to 2.2% by 2022 Q4 as a result of excess demand growth and domestic inflationary pressures building gradually.
The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain economic growth and employment. At its latest meeting on 18 December 2019, the MPC voted by a majority of 7-2 to maintain Bank Rate at 0.75%. The MPC assesses that monetary policy could respond in either direction to changes in the economic outlook in order to ensure a sustainable return of inflation to the 2% target. The MPC will, among other factors, continue to monitor closely the responses of companies and households to Brexit developments as well as the prospects for a recovery in global growth.

Some recently published UK economic data points to the prospect of a cut in Bank Rate by the MPC in 2020.

The longer term trend for Public Works Loan Board (PWLB) borrowing rates is to rise at a gradual pace.

4.10 Prospects for Interest Rates

SPT has appointed Link Asset Services as its treasury advisor and the following table gives their current view on the prospects for interest rates.

Table 11	Bank Rate	PWLB Borrowing Rates		
	%	5 year	10 year	25 year
March 2020	0.75%	2.40%	2.70%	3.30%
June 2020	0.75%	2.40%	2.70%	3.40%
September 2020	0.75%	2.50%	2.70%	3.40%
December 2020	0.75%	2.50%	2.80%	3.50%
March 2021	1.00%	2.60%	2.90%	3.60%
June 2021	1.00%	2.70%	3.00%	3.70%
September 2021	1.00%	2.80%	3.10%	3.70%
December 2021	1.00%	2.90%	3.20%	3.80%
March 2022	1.00%	2.90%	3.20%	3.90%
June 2022	1.25%	3.00%	3.30%	4.00%
September 2022	1.25%	3.10%	3.30%	4.00%
December 2022	1.25%	3.20%	3.40%	4.10%
March 2023	1.25%	3.20%	3.50%	4.10%

5. Capital Strategy 2020/21

The CIFPA Prudential Code for Capital Finance in Local Authorities (the “Prudential Code”) requires SPT to produce an annual Capital Strategy.

The purpose of the Capital Strategy is to ensure that capital expenditure and investment decisions are aligned with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability. In addition, the Capital Strategy should take a long-term view and not just consider the approved programme. The Capital Strategy should also form part of SPT’s integrated revenue, capital and balance sheet planning.

5.1 Capital Plan 2020/21 to 2022/23

The proposed Capital Plan 2020/21 to 2022/23, including the Capital Budget 2020/21, is being submitted separately for consideration by the Committee at its meeting on 7 February 2020. The aim of the Capital Strategy is to take a long term view on SPT’s capital investment requirements, however this is challenging in the current environment.

The first challenge relates to balancing a capital budget and delivery of a plan in the context of a one-year financial settlement. However, if capital investment across the region is to continue, then it is necessary to take a balanced approach to the assumptions made.

The second challenge relates to the Regional Transport Strategy (RTS), which is currently being updated. SPT’s capital investments are assessed against the priorities defined in the RTS and therefore the outcome of the RTS review will guide SPT’s long term investment aspirations.

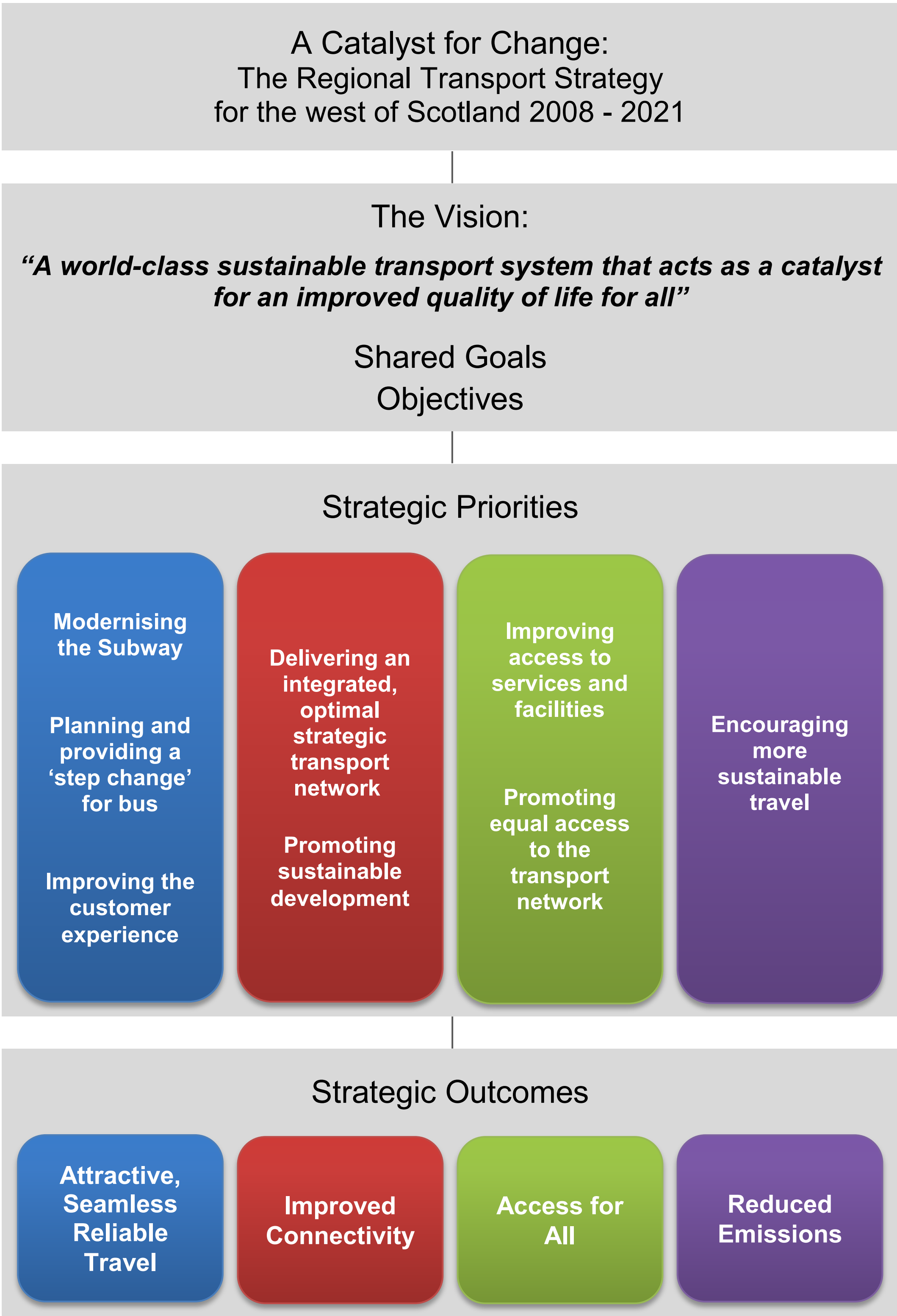
This Capital Strategy will focus on SPT’s current and short-term capital programmes, but will extrapolate known future spend to give a partial long-term view. The Capital Strategy will be reviewed and updated once future priorities and plans are clearer.

5.2 Links to Other Strategies, Plans, Regulations and Guidance

The Capital Strategy is aligned with the main strategic documents governing SPT. As mentioned above, the most significant of these is the RTS which sets the overall strategic priorities for the organisation and also defines the strategic outcomes that SPT strives to achieve through capital investment.

The following (Diagram 1) is an extract from the current Partnership approved RTS Delivery Plan.

Diagram 1: Regional Transport Strategy framework



The RTS Strategic Outcomes shown in Diagram 1 are further explained below:

RTS Outcome: Attractive Seamless Reliable Travel
Projects to support the delivery of a modern, integrated and attractive transport network include continuation of Subway Modernisation programme, bus passenger infrastructure improvements, improvements at key transport nodes and interchanges, travel information improvements including Real Time Passenger Information and development of smart, integrated ticketing.

RTS Outcome: Improved Connectivity
Projects to support the delivery of a more efficient and safe transport network including improvements to urban traffic control systems, junction improvements and safety improvements on rural roads.

RTS Outcome: Access for All
Projects to support the delivery of a more accessible and safe transport network include more accessible public transport and active travel infrastructure and bus fleet improvements on socially necessary services.

RTS Outcome: Reduced Emissions
Projects to support the delivery of a more sustainable transport network and travel behaviour include park and ride development, delivery or development of new cycling infrastructure and schemes in support of town centre regeneration plans to encourage more sustainable travel to work, shops and services.

When capital investment proposals are submitted they are evaluated against the current Strategic Priorities and Outcomes. The framework for the medium to long-term is under review as stated above. An update on the development of the RTS was reported to the Partnership on 20 September 2019.

In addition to the RTS, various other internal strategies and plans influence capital investment decisions:

- Treasury Management Strategy (included in this report)
- Prudential Indicators for Capital Financing (included in this report)
- Procurement Strategy (http://www.spt.co.uk/corporate/wp-content/uploads/2019/07/procurementstrategy_2019-2022.pdf)
- Asset Management Plans

Various external strategies either directly influence SPT's overall strategies or need to be considered when evaluating investment proposals:

- National Transport Strategy (https://www.transport.gov.scot/our-approach/national-transport-strategy/)
- Local Transport Strategies

5.3 Factors Influencing the Capital Programme

Projects can arise through a variety of both internal and external sources. Table 12 below summarises the most significant of these.

Table 12 **Factors influencing the capital programme**	
Internal	**External**
• Corporate Priorities • Investments identified in Strategies, Policies and Plans (including RTS Action Plan) • Work required on existing assets • Replacement of existing assets • ICT Investment and Replacement • Invest to Save Projects • Resources to deliver the programme	• National Transport Strategy • Government initiative / Specific Grant • Local Transport Plans • Economic Development • Emergencies • Works required to comply with legislation • Projects arising through Partnership working • Availability of external funding • Public expectations • Resources to deliver the programme

All of the above are considered when formulating the capital programme and revenue budget annually.

5.4 Governance of the Capital Programme

The Capital programme has various layers of governance that ensure the appropriate stewardship of SPT resources. The main areas can be summarised as:

- Capital Budgeting
- Programme Monitoring
- Project Management
- Risk Management
- Democratic Scrutiny

5.4.1 Capital Budgeting

SPT reviews its capital budget on an annual basis and has a defined process from seeking bids to final approval. For a project to be included for consideration within the capital programme a bid form must be completed, which captures:

- project description
- project scope
- project dependencies
- project justification and benefits
- links to the RTS Delivery Plan and Strategic Outcomes
- cost information
- programme information

All proposals are assessed by the Policy & Strategy Team, Finance Team and the Strategy Group to ensure that they fit with the RTS, are achievable, affordable and are also value for money. Major projects require supporting documentation such as Business Cases, Feasibility Studies, etc.

Once proposals have been internally reviewed and accepted the next stage is to submit the proposed Capital Plan to the Strategy & Programmes Committee or Partnership. The capital budget is approved by the Partnership for year one, with years two and three being indicative only. This is a consequence of the one-year financial settlement received by SPT.

5.4.2 Programme Monitoring

The capital programme is monitored on various levels and differs depending on the nature and the size of projects. SPT's capital programme can be split into three categories:

- standard projects
- major projects / programmes
- partner projects

Regardless of project type, the financial performance is reported to Project Managers and the Strategy Group on a 4-weekly basis. In addition, the performance is reported to the Strategy and Programmes Committee for noting and also for the approval of amendments.

An example of a current major project is the Subway Modernisation Programme. Due to the size and nature of the investment the programme has its own governance structure in addition to the overarching corporate structure. Progress throughout the programme is monitored by an internal project board, a project board (includes the main contractors) and also by specific reports to the Partnership.

Partner projects predominantly involve grant funding that SPT provides to other organisations, such as our constituent local authorities. Although the projects will be managed directly by the partners, they are still reported on internally in the same way as any other project. SPT officers are in contact with the partners on a regular basis, to ensure that the overall capital programme is managed and updated appropriately.

5.4.3 Project Management

SPT has a specific department with qualified project managers that are allocated to internal projects. All projects within SPT have a designated project manager who either comes direct from the project pool or from other staff throughout the organisation. Projects are managed in a controlled manner through the use of various project management techniques, including project plans, budgets etc.

For the Subway Modernisation projects there is a specific Project Management Office (PMO), in addition to various project managers for the different work streams and senior project managers. The role of the PMO is to ensure standardisation of working practices and processes across the various work streams and also to provide professional support and expertise to the individual project managers.

5.4.4 Risk Management

It is vital that risk is managed and mitigated where possible on all capital projects. In addition to SPT's corporate risk register individual projects have their own risk registers that are regularly reviewed.

5.4.5 Democratic Scrutiny

The Partnership, Strategy and Programmes Committee and Audit and Standards Committee all play a vital role in the governance of the capital programme. The roles of the individual committees are defined within the Committee Terms of Reference, which can be found within SPT's Governance Manual (http://www.spt.co.uk/corporate/wp-content/uploads/2019/10/sptgovernancemanual.pdf).

The Partnership's role is to approve the capital budget and also any associated strategies. In addition, regular updates on major projects are submitted to the Partnership for scrutiny. The Strategy & Programmes Committee is responsible for the monitoring of the capital programme and approving any in-year amendments. The Audit & Standards Committee has the opportunity to scrutinise reports in relation to the capital projects / programme specifically and also practices and processes relating to capital works.

5.5 Funding the Capital Programme

The capital programme can be funded through various different sources as shown in Table 13 below.

Table 13
Sources of capital funding

Internal	External
• Capital Receipts • Reserves • Contribution from Revenue	• Government Grants • Other Grants (e.g. ERDF) • Contributions from Partners • Other Contributions • Borrowing

SPT's primary source of funding is Government Grants, both specific and general. The proposed 2020/21 capital budget is planned to be fully funded from capital grants. As is normal
the expenditure is set greater than the available funding to ensure that the plan delivery is maximised within the funding available and project delivery movements.

Although SPT has the power to borrow, currently it is debt-free and there are no plans to borrow.

5.6 Revenue Implications

The revenue implications of investment decisions are considered when proposals are being assessed for inclusion within the capital programme. The revenue effects of investment decisions are:

- increased running or maintenance costs
- savings generated through a spend to save initiative
- loss of interest if a project is funded from reserves / capital receipts
- borrowing costs if SPT decided to borrow to fund a specific project or the programme as a whole

SPT will always have regard to the affordability of its proposed capital investments, in terms of the revenue implications arising. The revenue implications of investment decisions will always be reflected in revenue budgets and outturns.

5.7 Long-term Capital Projections

As mentioned above, it is challenging to develop long-term capital plans in the context of a one-year financial settlement, when future funding is not known, and at a time when SPT is currently updating its primary strategic document (the RTS). However, there are clear capital themes, which are likely to continue going forward. In addition, there are major works that SPT is either currently undertaking or planning for future years. Table 14 below details the themes and major works by Directorate / Service.

Table 14
Themes and major works

Directorate / Service	Continuing Themes	Major Works
Bus Operations	• Bus Stops and Shelters • Purchase of Buses and Operational Vehicles • Real Time Passenger Information (RTPI)	• Modernisation of Bus Stations
Subway	• Tunnel & Infrastructure Works • Depot Improvements • Station Minor Works • Plant & Equipment	Subway Modernisation • Station Improvements • Rolling Stock & New System
Projects / Local Authority	• Integrated Ticketing • Bus Infrastructure Works • RTPI • Park & Ride • Cycling Projects • Active Travel Projects • Route / Corridor / Junction Improvements • Rail Station Improvements / Developments	***Major future projects are dependent on the outcome of the RTS review***
Digital	• Technical Refresh • Systems Development	
Corporate	• Capitalised Salaries • System Improvements • Advertising Infrastructure • Property Works	

Based on current themes and historic spend a broad estimation can be made on the projected capital programme by Directorate / Service over the next 10 years, as shown in Table 14 below.

Table 15 Projected capital programme 2020/21 to 2029/30

	Forecast	Estimated		Projected						
Directorate / Service	**2020/21 £000**	**2021/22 £000**	**2022/23 £000**	**2023/24 £000**	**2024/25 £000**	**2025/26 £000**	**2026/27 £000**	**2027/28 £000**	**2028/29 £000**	**2029/30 £000**
Bus Operations	2,095	1,150	1,150	1,500	1,500	1,500	1,500	1,500	1,500	1,500
Corporate	140	75	75	75	75	75	75	75	75	75
Customer Standards	50	50	50	50	50	50	50	50	50	50
Digital	595	75	75	100	100	100	100	100	100	100
Projects	2,755	375	0	2,000	4,000	4,000	4,000	4,000	4,000	4,000
Subway	43,858	38,551	14,742	46,546	4,000	4,000	9,500	6,000	4,000	4,000
Local Authorities and Others	14,840	17,555	18,700	15,000	15,000	15,000	15,000	15,000	15,000	15,000
Total	**64,333**	**57,831**	**34,792**	**65,271**	**24,725**	**24,725**	**30,225**	**26,725**	**24,725**	**24,725**

6. Committee action

The Committee is requested to consider this report and to approve:

(a) the Treasury Management Strategy Statement and Annual Investment Strategy for financial year 2020/21;

(b) SPT's prudential indicators as detailed in the report;

(c) the Permitted Investment Types detailed in Appendix 1;

(d) the Counterparty List detailed in Appendix 3; and

(e) the Capital Strategy.

7. Consequences

Policy consequences	*None*
Legal consequences	*All legislation and regulations are adhered to.*
Financial consequences	*The contents of this report have been incorporated into SPT's 2020/21 budgets.*
Personnel consequences	*None*
Equalities consequences	*None*
Risk consequences	*As detailed in report*

Name	Valerie Davidson	**Name**	Gordon Maclennan
Title	**Assistant Chief Executive**	**Title**	**Chief Executive**

For further information, please contact Neil Wylie, Director of Finance, on 0141 333 3380.

Permitted Investment Types

1. Cash type instruments	
a)	**Call accounts with high credit worthiness banks and building societies** Cash is deposited with the institution and is held at instant access or at call. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. However, use of call accounts is necessary to ensure that SPT has ready access to cash when required. These tend to be low risk investments depending on the credit rating. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice (up to 100 days).
b)	**Term deposits with high credit worthiness banks and building societies** Cash is deposited with the institution until an agreed maturity date. The cash is locked in until the maturity date however the rate of interest is fixed for the duration of the deposit. These tend to be low risk investments depending on the credit rating. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.

2. Other investments	
a)	**Investment properties** Investment properties include retail outlets contained within assets owned by SPT and other land and buildings, which are leased to third parties. These assets are being held for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).
b)	**Shareholdings in joint venture companies** SPT owns 49% of the ordinary shares in Nevis Technologies Limited, a joint venture between SPT and Ecebs Limited for the provision of a smartcard ticketing and payment service. Other such joint venture arrangements may arise in the future. These assets are not being held for the purpose of producing an income stream or potential capital gain. These are highly illiquid assets with high risk to value (generally the shares are not traded on a market).

Treasury Risks and Mitigation

Investment type	Minimum credit criteria / colour banding	Liquidity risk	Market risk	Maximum limit	Maximum maturity period
Call accounts with high credit worthiness banks and building societies	Green	instant access or call (up to 100 days)	no	100%	up to 100 days
Term deposits with high credit worthiness banks and building societies	Red	term	no	50%	up to 1 year
Investment properties	n/a	sale	yes	£15m	n/a
Shareholdings in joint venture companies	n/a	sale	yes	£0.5m	n/a

Treasury Risks

Credit and counterparty risk: this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to SPT particularly as a result of the counterparty’s diminished creditworthiness, and the resulting detrimental effect on SPT’s capital or revenue resources. There are no counterparties where this risk is zero although AAA rated organisations have the highest, relative, level of creditworthiness.

Liquidity risk: this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument.

Market risk: this is the risk that, through adverse market fluctuations in the value of the principal sums SPT borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

Interest rate risk: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on SPT’s finances, against which SPT has failed to protect itself adequately.

Legal and regulatory risk: this is the risk that SPT itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that SPT suffers losses accordingly.

Controls on Treasury Risks

Credit and counterparty risk: SPT has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes.

Liquidity risk: SPT has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

Market risk: SPT does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value. Investment properties are valued annually at fair value and movements in valuations are recognised in the annual accounts. Shareholdings in joint venture companies are recorded as financial assets at cost, less any provision for losses.

Interest rate risk: SPT manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing.

Legal and regulatory risk: SPT will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited Investments

Regulation 24 states that an investment can classed as being ‘unlimited’ in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

SPT has given the following types of investment an unlimited category: -

Call accounts with high credit worthiness banks and building societies: to ensure that SPT has ready access to cash when required, an unlimited amount of the investment portfolio may be put into call accounts with high credit worthiness banks and building societies. However, SPT will diversify its portfolio through its counterparty limits policy, thereby ensuring that no more than £50m or 50% of total balances can be placed with any one counterparty at any one time (subject to a tolerance level of 2% of the balance held with each counterparty).

SPT's Counterparty List 2020/21

Counterparty Institution	Country / Classification	Band
Abbey National Treasury Services PLC	UK / Bank	Red
Bank of Scotland PLC #	UK / Bank	Orange
Barclays Bank PLC #	UK / Bank	Red
Barclays Bank UK PLC	UK / Bank	Red
Close Brothers Ltd	UK / Bank	Red
Goldman Sachs International Bank #	UK / Bank	Red
Handelsbanken Plc	UK / Bank	Orange
HSBC Bank PLC	UK / Bank	Orange
HSBC UK Bank Plc #	UK / Bank	Orange
Lloyds Bank Corporate Markets Plc	UK / Bank	Red
Lloyds Bank Plc	UK / Bank	Orange
NatWest Markets Plc	UK / Bank	Green
Santander UK PLC #	UK / Bank	Red
Standard Chartered Bank	UK / Bank	Red
Sumitomo Mitsui Banking Corporation Europe Ltd	UK / Bank	Red
National Westminster Bank PLC	UK / Part Nationalised Bank	Blue
The Royal Bank of Scotland Plc #	UK / Part Nationalised Bank	Blue
Coventry Building Society	UK / Building Society	Red
Leeds Building Society	UK / Building Society	Green
Nationwide Building Society #	UK / Building Society	Red
Skipton Building Society	UK / Building Society	Green
Yorkshire Building Society	UK / Building Society	Green

 # Investment balances have been held with this counterparty so far during financial year 2019/20

Colour Code	Duration (up to)
Yellow	5 years
Purple	2 years
Blue	1 year (only applies to UK Part Nationalised Banks)
Orange	1 year
Red	6 months
Green	100 days
No Colour	0 days (i.e. not to be used)

Treasury Management Policy Statement

Strathclyde Partnership for Transport has defined the policies and objectives of its treasury management activities as follows:

(A) SPT defines its treasury management activities 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.”

(B) SPT regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

(C) SPT acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Treasury Management Scheme of Delegation

Partnership

- approval of annual strategy;
- budget consideration and approval;
- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of / amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- approval of the division of responsibilities.

Strategy & Programmes Committee

- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment;
- reviewing the treasury management policy and procedures and making recommendations to the Partnership.

The role of the Section 95 officer

The Assistant Chief Executive is the Section 95 (responsible) officer and has the following role:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the organisation;
- ensuring that the organisation has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the organisation does not undertake a level of investing which exposes the organisation to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees ensuring that members are adequately informed and understand the risk exposures taken on by an organisation;
- ensuring that the organisation has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non-treasury investments will be carried out and managed, to include the following:
    - risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
    - training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.