Committee report

SPT

Annual Treasury Management Report 2018/19

Committee Strategy & Programmes

Date of meeting 30 August 2019 **Date of report** 20 August 2019

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 2018/19. 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 strategy report for the year ahead 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."

During financial year 2018/19 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year (Partnership, 23 February 2018)
- a mid-year treasury update report (Strategy & Programmes, 23 November 2018)
- 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.

In December 2017, CIPFA issued a revised "The Prudential Code for Capital Finance in Local Authorities". The issue of a revised Prudential Code at such a late stage in the planning for financial year 2018/19 has meant that SPT will not be able to fully implement its requirements until 2019/20.

3. The Economy in 2018/19

Economic growth (GDP) was estimated to have increased by 1.4% in calendar year 2018, slightly below the 1.8% growth in 2017. This slowdown mainly reflects softer activity abroad and the greater effects from Brexit uncertainties at home. Global financial conditions have eased, in part supported by announcements of more accommodative policies in some major economies. The expectation is for GDP annual growth rates of 1.3% in 2019, 1.3% in 2020 and 2.3% in 2021.

Consumer Price Index (CPI) inflation fell from 2.4% in April 2018 to 1.9% in March 2019, having peaked at 2.7% in August 2018. During the financial year, inflation had been pushed above the UK Government's 2% target by the increase in import prices that resulted from the past devaluation of sterling and higher energy prices. The expectation is for inflation to fall in the near-term and to then rise above the 2% target in the longer-term.

The unemployment rate fell slightly from 4.0% in April 2018 to 3.8% in February 2019, its lowest level since 1975. Wage growth has continued to strengthen amid the tight conditions in the labour market, contributing to domestic inflationary pressures. The expectation is that the unemployment rate will continue to fall slightly over the longer-term.

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. At its meeting on 1 August 2018, the MPC reacted to the economic outlook by raising Bank Rate from 0.50% to 0.75%, only the second rate rise in 10 years. At its meeting on 20 March 2019 the MPC maintained Bank Rate at 0.75%. The expectation is that any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent, however post 2018/19 the prospect of rate rises has significantly reduced.

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

The economic outlook will continue to depend significantly on the nature of the UK's withdrawal from the EU, in particular: the new trading arrangements between the UK and the EU; whether the transition to them is abrupt or smooth; and how households, businesses and financial markets respond.

The MPC assesses that increased uncertainty about the nature of EU withdrawal means that the economy could follow a wide range of paths over coming years. The appropriate path of monetary policy will depend on the balance of the effects of Brexit on demand, supply and the exchange rate. The monetary policy response to Brexit, whatever form it takes, will not be automatic and could be in either direction.

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	**2016/17 Actual £000**	**2017/18 Actual £000**	**2018/19 Actual £000**
Capital Programme expenditure	**59,648**	**39,960**	**58,852**
Capital grants and contributions	40,761	39,946	58,852
Revenue contribution to the capital programme	1,800	0	0
Subway fund utilisation	17,087	0	0
Transfers from reserves (including Unapplied Capital Grants)	0	14	0
Borrowings	0	0	0
Capital Funding	**59,648**	**39,960**	**58,852**

5. Overall Treasury Position

At the beginning and end of 2018/19 SPT's debt position was as shown in Table 2 below:

Table 2	**Principal 31 March 2018 £000**	**Principal 31 March 2019 £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 2021/22 do not require any borrowing.

At the beginning and end of 2018/19 SPT's investment position was as shown in Table 3 below:

Table 3	Principal 31 March 2018 £000	Principal 31 March 2019 £000	Interest Earned £000
Deposits with banks and building societies	168,153	170,519	1,379

As can be seen from Table 3, SPT earned interest of £1.379m during 2018/19. This is an increase of £0.715m when compared to the interest earned of £0.664m during 2017/18, mainly as a result of the increases in the investment rates earned and in the average level of investment balances held during 2018/19.

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

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.

During financial year 2018/19 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2018/19.

Details of the Prudential and Treasury Management Indicators are shown in Appendix 1.

7. Annual Investment Strategy

The Annual Investment Strategy for 2018/19 was reported to and approved by the Partnership on 23 February 2018.

Investment Policy

The 2018/19 strategy states that "SPT's investment priorities will be security first, liquidity second and then return."

Permitted Investments

The 2018/19 strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Creditworthiness

The 2018/19 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 2018/19 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 2018/19 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 23 February 2018.

The result of the Annual Investment Strategy for 2018/19 is shown in Table 4 below:

Table 4	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	4,293	0.52	0.51	Instant Access
Account 2	22,692	0.92	0.51	95 Day Notice
Account 3	15,846	0.90	0.51	Fixed Term
Account 4	19,325	0.72	0.51	Instant Access
Account 5	387	0.72	0.51	Instant Access
Account 6	11,203	0.72	0.51	32 Day Notice
Account 7	31,338	0.90	0.51	95 Day Notice
Account 8	1,538	0.95	0.51	Fixed Term
Account 9	7,431	0.60	0.51	Instant Access
Account 10	22,836	0.94	0.51	95 Day Notice
Account 11	0	0.12	0.51	Instant Access
Account 12	0	0.52	0.51	95 Day Notice
Account 13	4	0.40	0.51	Instant Access
Account 14	4	0.53	0.51	31 Day Notice
Account 15	27,308	0.81	0.51	95 Day Notice

* The benchmark return is the 7 day LIBID uncompounded

The overall average rate of return equates to 0.84%, which exceeds the benchmark by 0.33% per annum.

As can be seen from Table 4, the Partnership 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 4, the Partnership holds its investment balances with a blend of liquidity in cognisance of cashflow requirements.

9. Control of Interest Rate Risk

Investment returns remained low during 2018/19. The expectation for interest rates within the 2018/19 Treasury Management Strategy was that Bank Rate would rise from 0.50% to 0.75%.

At the start of 2018/19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of an increase in Bank Rate was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. Subsequently, the MPC did raise Bank Rate to 0.75% at its meeting on 2 August 2018. During this period, investments were therefore kept relatively shorter-term in anticipation that rates would be higher later in the year.

After August, it was not expected that the MPC would raise Bank Rate again during 2018/19 in view of the fact that the UK was entering into a time of uncertainty with Brexit due in March 2019. During this period, value was therefore sought by placing longer-term investments where cash balances were sufficient to allow this.

10. Conclusion

During the financial year 2018/19 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2018/19.

The Annual Investment Strategy for 2018/19 was followed in full.

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 2018/19 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*

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

For further information, please contact Stuart Paul, Chief Accountant, on 0141 333 3382.

Appendix 1

Prudential and treasury management indicators	2017/18 Actual £000	2018/19 Forecast £000	2018/19 Actual £000
		Note (1)	
Prudential indicators			
Capital Expenditure	39,960	74,525	58,852
Ratio of financing costs to net revenue stream	-3%	-2%	-7%
Net borrowing requirement / (net investments) Note (2)			
Brought forward 1 April	(88,140)	(144,813)	(168,153)
Carried forward 31 March	(168,153)	(94,987)	(170,519)
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	30,000	60,000	60,000
Authorised Limit	33,000	66,000	66,000
Principal sums invested > 365 days Note (3)			
Indicator	0	0	10,000
Authorised Limit	25,000	25,000	25,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2018/19.

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.