

Treasury Management Strategy 2016/17

Committee Strategy and Programmes

Date of meeting 18 March 2016

Date of report 8 March 2016

Report by Assistant Chief Executive (Business Support)

1. Object of report

To update members on treasury management processes and seek approval for the proposed treasury management strategy for the financial year 2016/17.

2. Background

SPT has adopted the CIPFA Code of Practice on Treasury Management and fully complies with its requirements.

The primary requirements of the Code 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 local authority's cash flows; its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of the 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.

This report covers:

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

3. Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

Capital issues

- the capital plans and the prudential indicators.

Treasury management issues

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

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 Committee 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 2016/17 to 2018/19 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 2017/18 to 2018/19 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.

4. The Capital Prudential Indicators 2015/16 to 2018/19

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.

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4.1 Capital expenditure

This prudential indicator is a summary of SPT's capital expenditure plans.

Table 1	2014/15 Actual £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
Capital Expenditure	40,693	56,622	72,435	93,411	50,225
Capital grants and contributions	25,135	22,577	36,070	36,000	36,000
Revenue contribution to the capital programme	5,802	2,000	1,800	1,700	1,700
Subway fund utilisation	9,735	12,840	14,750	29,770	5,304
General Fund	0	1,357	0	0	0
Capital Receipts Reserve	21	6,708	1,465	6,511	0
Capital Grants Unapplied Account	0	11,140	18,350	1,650	0
Borrowings	0	0	0	17,780	7,221
Capital Funding	40,693	56,622	72,435	93,411	50,225

4.2 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

Table 2	2014/15 Actual £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
Capital Financing Requirement	0	0	0	17,780	25,001

4.3 The Use of SPT's Resources and the Investment Position

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.

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Table 3 Year End Resources	2014/15 Actual £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
General Fund Balance	12,526	11,169	11,169	11,169	11,169
Capital Receipts Reserve	22,815	16,107	14,642	8,131	8,131
Capital Grants Unapplied Account	34,125	22,985	4,635	2,985	2,985
Provisions	741	741	741	741	741
Subway fund	30,944	27,334	20,887	0	0
Total core funds	101,151	78,336	52,074	23,026	23,026
Investments	101,168	78,353	52,091	23,043	23,043

4.4 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 the SPT's overall finances.

Actual and estimates of the 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	2014/15 Actual	2015/16 Forecast	2016/17 Forecast	2017/18 Estimate	2018/19 Estimate
SPT	-2%	-1%	-2%	1%	1%

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

5. Treasury Management Consultants

SPT uses Capita 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, whilst recognising the value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

6. Treasury Management Strategy

The capital expenditure plans set out in Section 4 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. 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.

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6.1 Current Portfolio Position

SPT's treasury portfolio position, with forward projections is summarised below. The table 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 5	2014/15 Actual £000	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
External Debt					
Debt at 1 April	0	0	0	0	17,780
Expected change in Debt	0	0	0	17,780	7,221
Actual debt at 31 March	0	0	0	17,780	25,001
The Capital Financing Requirement	0	0	0	17,780	25,001
Under / (over) borrowing	0	0	0	0	0
Investments	80,455	101,068	78,353	52,091	23,043
Investment change	20,713	-22,815	-26,262	-29,048	0
Total Investments	101,168	78,353	52,091	23,043	23,043
Net Debt	-101,168	-78,353	-52,091	-5,263	1,958

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 total debt, net of any investments, 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 2015/16 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 purposes.

6.2 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 would also include an allowance for risk.

Table 6 Operational Boundary	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
Debt	20,000	20,000	30,000	60,000

The Authorised Limit for external borrowing: A further key prudential indicator represents a control on the maximum level of debt. This represents a 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.

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Table 7 Authorised Limit	2015/16 Forecast £000	2016/17 Forecast £000	2017/18 Estimate £000	2018/19 Estimate £000
Debt	22,000	22,000	33,000	66,000

6.3 Prospects for Interest Rates

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

Table 8 Annual Average %	Bank Rate	PWLB Borrowing Rates %		
	%	5 year	25 year	50 year
March 2016	0.50	2.00	3.40	3.20
June 2016	0.50	2.10	3.40	3.20
September 2016	0.50	2.20	3.50	3.30
December 2016	0.75	2.30	3.60	3.40
March 2017	0.75	2.40	3.70	3.50
June 2017	1.00	2.50	3.70	3.60
September 2017	1.00	2.60	3.80	3.70
December 2017	1.25	2.70	3.90	3.80
March 2018	1.25	2.80	4.00	3.90
June 2018	1.50	2.90	4.00	3.90
September 2018	1.50	3.00	4.10	4.00
December 2018	1.75	3.10	4.10	4.00
March 2019	1.75	3.20	4.10	4.00

6.4 Economic Outlook

Compared to the other G7 countries, there was relatively strong economic growth (GDP) in the UK in 2013 (2.2%) and 2014 (2.9%) although it weakened slightly in 2015 (2.2%). The forecast is that economic growth will remain relatively strong over the next three years at around 2.2% to 2.4%, driven mainly by consumer demand as a result of the recovery in disposable incomes.

Consumer Price Index (CPI) inflation was 0.3% in January 2015 and remained at, or near to, 0% for most of the year before ending at 0.2% in December 2015. Falling prices for motor fuels and food were the main contributors. The forecast is that CPI inflation will remain low and it may take 2-3 years to get back to the Monetary Policy Committee (MPC) target of 2.0%.

Bank rate remains unchanged at 0.5%. The weakening of UK growth and the prospects of CPI inflation remaining below the MPC target have consequently led to forecasts for when the Bank Rate will start to increase being pushed back. Bank Rate is forecast to start increasing gradually from Quarter 4 2016.

The longer term trend is still for Public Works Loan Board (PWLB) borrowing rates to rise.

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Importantly for SPT, expectations of increased UK interest rates continue to be delayed and actual investment rates continue to fall. In particular, the rates earned on instant access and short term notice accounts.

Clearly the economic outlook will be monitored following the recent announcement with regard to the EU Referendum.

6.5 Borrowing Strategy

SPT is currently debt free, but may need to borrow in the near future to fund the Subway Modernisation programme. The funding schedule submitted to government in support of the programme is based on borrowing occurring in two phases.

There are three debt related treasury activity limits. The purpose of these indicators are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce SPT's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Table 9 Interest Rate Exposures	Percentage of outstanding principal sums
Borrowing	
Limits on fixed interest rate exposures	60 to 100
Limits on variable interest rate exposures	0 to 40
Investing	
Limits on fixed interest rate exposures	0 to 50
Limits on variable interest rate exposures	50 to 100

Table 10 Maturity Structure of Borrowing		
The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate.		
	Lower Limit %	Upper Limit %
under 12 months	0	50
12 months and within 24 months	0	100
24 months and within 5 years	0	100
5 years and within 10 years	0	100
10 years and within 25 years	10	100
25 years and within 50 years	10	100

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6.6 Policy on Borrowing in Advance of Need

The timing of any borrowings 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. 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.

6.7 Annual Investment Strategy

6.7.1. Investment Policy

SPT's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). SPT's investment priorities will be security first, liquidity second and then return.

In accordance with the above guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, SPT has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. Potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, SPT officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end SPT will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps (CDS)" and overlay that information on top of the credit ratings.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

6.7.2. Creditworthiness Policy

SPT applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and 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.

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SPT will therefore use counterparties within the following durational bands.

Colour code	Duration (up to)
Yellow	60 Months
Purple	24 Months
Blue	12 Months (only applies to U.K. Nationalised and Part Nationalised Banks)
Orange	12 Months
Red	6 Months
Green	100 Days
No Colour	0 Months (i.e. not to be used)

The Capita Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

A full list of SPT's potential counterparties can be found at Appendix 1.

SPT will not make investments for more than 12 months.

6.7.3. 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.

Although SPT only invests in UK institutions at present details of all permitted investments can be found at Appendix 2.

6.7.4. 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.

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6.7.5. Investment Treasury Indicator and Limit

The Investment Treasury Indicator and Limit is the total principal funds invested for greater than 364 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 12	2015/16 £000	2016/17 £000	2017/18 £000	2018/19 £000
Principal sums invested > 364 days	35,000	35,000	25,000	15,000

7. Committee action

The committee is recommended to:

- (a) approve the Treasury Management Strategy for 2016/17;
- (b) approve SPT's prudential indicators as detailed in the report;
- (c) approve the Counterparty List detailed in Appendix 1;
- (d) approve the Permitted Investment Types detailed in Appendix 2.

8. Consequences

Policy consequences	<i>None</i>
Legal consequences	<i>All legislation and regulations are adhered to.</i>
Financial consequences	<i>The contents of this report have been incorporated into SPT's 2016/17 budgets.</i>
Personnel consequences	<i>None</i>
Equalities consequences	<i>None</i>
Risk consequences	<i>As detailed in report</i>

Name Valerie Davidson
Title **Assistant Chief Executive
(Business Support)**

Name Gordon MacLennan
Title **Chief Executive**

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

SPT's Counterparty List

Counterparty Institution	Country / Classification	Band
Abbey National Treasury Services plc	U.K.	Red
Bank of Scotland Plc	U.K.	Red
Barclays Bank plc	U.K.	Green
Close Brothers Ltd	U.K.	Red
Goldman Sachs International Bank ~	U.K.	Green
HSBC Bank plc	U.K.	Red
Lloyds Bank Plc	U.K.	Red
Santander UK plc	U.K.	Red
Sumitomo Mitsui Banking Corporation Europe Ltd ~	U.K.	Red
UBS Ltd ~	U.K.	Red
Coventry BS	U.K. Building Societies	Red
Leeds BS	U.K. Building Societies	Red
Nationwide BS	U.K. Building Societies	Red
Yorkshire BS	U.K. Building Societies	Green
Collateralised LA Deposit*	AAA rated and Government backed securities	Yellow
Debt Management Office	AAA rated and Government backed securities	Yellow
Supranationals	AAA rated and Government backed securities	Yellow
UK Gilts	AAA rated and Government backed securities	Yellow
National Westminster Bank Plc	Nationalised and Part Nationalised Banks	Blue
Royal Bank of Scotland Group plc	Nationalised and Part Nationalised Banks	Blue
The Royal Bank of Scotland Plc	Nationalised and Part Nationalised Banks	Blue
National Bank of Abu Dhabi	Abu Dhabi (U.A.E)	Orange
Australia and New Zealand Banking Group Ltd	Australia	Orange
Commonwealth Bank of Australia	Australia	Orange
Macquarie Bank Limited	Australia	Green
National Australia Bank Ltd	Australia	Orange
Westpac Banking Corporation	Australia	Orange
BNP Paribas Fortis	Belgium	Red
KBC Bank NV	Belgium	Red
Bank of Montreal	Canada	Orange
Bank of Nova Scotia	Canada	Orange
Canadian Imperial Bank of Commerce	Canada	Orange

Counterparty Institution	Country / Classification	Band
National Bank of Canada	Canada	Red
Royal Bank of Canada	Canada	Orange
Toronto Dominion Bank	Canada	Orange
Danske Bank	Denmark	Red
Nordea Bank Finland plc ~	Finland	Orange
Pohjola Bank	Finland	Orange
BNP Paribas	France	Red
Credit Agricole Corporate and Investment Bank	France	Red
Credit Agricole SA	France	Red
Credit Industriel et Commercial	France	Red
Societe Generale	France	Green
BayernLB	Germany	Red
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	Germany	Orange
Landesbank Baden Wuerttemberg	Germany	Red
Landesbank Berlin AG	Germany	Orange
Landesbank Hessen-Thueringen Girozentrale (Helaba)	Germany	Orange
Landwirtschaftliche Rentenbank	Germany	Purple
Norddeutsche Landesbank Girozentrale	Germany	Red
NRW.BANK	Germany	Purple
ABN AMRO Bank N.V.	Netherlands	Red
Bank Nederlandse Gemeenten	Netherlands	Purple
Cooperatieve Rabobank U.A.	Netherlands	Orange
ING Bank NV	Netherlands	Red
Nederlandse Waterschapsbank N.V	Netherlands	Purple
Qatar National Bank	Qatar	Orange
DBS Bank Ltd	Singapore	Orange
Oversea Chinese Banking Corporation Ltd	Singapore	Orange
United Overseas Bank Ltd	Singapore	Orange
Nordea Bank AB	Sweden	Orange
Skandinaviska Enskilda Banken AB	Sweden	Orange
Svenska Handelsbanken AB	Sweden	Orange
Swedbank AB	Sweden	Orange
Credit Suisse AG	Switzerland	Green
UBS AG	Switzerland	Red
Bank of America, N.A.~	U.S.A	Red
Bank of New York Mellon, The	U.S.A	Purple
Citibank, N.A. ~	U.S.A	Green

Counterparty Institution	Country / Classification	Band
JPMorgan Chase Bank NA	U.S.A	Orange
Wells Fargo Bank NA	U.S.A	Purple

Key to bands used on Counterparty List:	
Colour Code	Duration (up to)
Yellow	60 Months
Purple	24 Months
Blue	12 Months (only applies to U.K. Nationalised and Part Nationalised Banks)
Orange	12 Months
Red	6 Months
Green	100 Days
No Colour	0 Months (i.e. not to be used)

Permitted Investment Types

1. Cash type instruments	
a)	Deposits with the Debt Management Account Facility (UK Government)
b)	Deposits with other local authorities or public bodies
c)	Money Market Funds (MMFs)
d)	Enhanced Money Market Funds (EMMFs)
e)	Call account deposit accounts with financial institutions (banks and building societies)
f)	Term deposits with financial institutions (banks and building societies)
h)	Government Gilts and Treasury Bills
i)	Certificates of deposits with financial institutions
j)	Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.)

2. Other investments	
a)	Investment properties
b)	Loans to third parties, including soft loans
c)	Loans to a local authority company
d)	Shareholdings in a local authority company
e)	Non-local authority shareholdings

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 investments and cash flows, its banking, money markets 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.