Committee report

Mid-Year Treasury Management Report 2020/21

Committee Strategy and Programmes

Date of meeting 20 November 2020 **Date of report** 11 November 2020

Report by Assistant Chief Executive

1. Object of report

SPT is required by regulation issued under the Local Government in Scotland Act 2003 to produce a mid-year report reviewing treasury management activities undertaken in the first half of the financial year. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the "Code of Practice") and the CIPFA Prudential Code for Capital Finance in Local Authorities (the "Prudential Code").

2. Background

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

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

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

Treasury management in this context is defined as:

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

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 an update on treasury activities and highlights compliance with the Partnership's policies previously approved by members.

3. The Economy and Interest Rates

3.1 Economic performance to date and outlook

The lockdown measures introduced to protect public health in response to the Covid-19 pandemic in March 2020 restricted economic activity and resulted in a sudden fall in economic growth (GDP). UK GDP in volume terms is estimated to have fallen by 19.8% in 2020 Quarter 2 (April to June). The expectation is that UK GDP will continue to recover beyond the near term, but is not projected to exceed its level in 2019 Quarter 4 until the end of 2021.

CPI inflation has fallen from 0.8% in April 2020 to 0.5% in September and is expected to fall further in 2020, largely reflecting the direct and indirect effects of Covid-19. These include the impact of energy prices and the temporary cut in VAT for hospitality, holiday accommodation and attractions. As these effects unwind, inflation rises, supported by a gradual strengthening of domestic price pressures and is expected to be around 2% in two years' time.

The unemployment rate was 4.0% in the three months to April 2020. Employment has fallen since the Covid-19 outbreak, although this has been significantly mitigated by the extensive take-up of support from temporary government schemes. Surveys indicate that many workers have already returned to work from furlough, but considerable uncertainty remains about the prospects for employment after those support schemes unwind. Average earnings are expected to fall and, in the near term, the unemployment rate is expected to rise materially to around 7.5%.

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 meeting on 4 August 2020 the MPC voted unanimously to maintain Bank Rate at 0.10% and to continue its' existing programme of Quantitative Easing at £745bn.

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

The MPC will continue to monitor the situation closely and stands ready to adjust monetary policy accordingly to meet its remit. The MPC will keep under review the range of actions that could be taken to deliver its objectives. The MPC does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

3.2 Link Asset Services' forecast for Bank Rate interest

Table 1 below shows the forecast for Bank Rate interest provided by Link Asset Services, SPT's treasury advisor.

Table 1										
Now	**Dec-20**	**Mar-21**	**Jun-21**	**Sep-21**	**Dec-21**	**Mar-22**	**Jun-22**	**Sep-22**	**Dec-22**	**Mar-23**
0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10

The investment environment is now one characterised by very low rates of return. However, SPT's investment priorities continue to be security first, liquidity second and then return.

4. Treasury Management Strategy Update

The Treasury Management Strategy 2020/21, including the Annual Investment Strategy, was approved by the Partnership on 6 March 2020.

The Annual Investment Strategy has been reviewed in light of the significant changes in the investment environment since the Strategy was originally approved in March.

SPT continues to only hold investment balances with approved UK institutions and to act in accordance with the credit rating service provided by our treasury advisors, Link Asset Services. However, some additional flexibility is sought in terms of the individual counterparty limits, to enable SPT to better manage the level of investment balances across its' counterparties whilst maintaining its' investment policy of security first, liquidity second and then return.

The 2020/21 Strategy sets out SPT's 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; and
- To allow for temporary operational circumstances, there is a tolerance level of 2% of the balance held with each counterparty.

It is proposed that SPT's counterparty limits are revised as follows:

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

There are no other proposed policy changes to the Treasury Management Strategy. The information in this report updates the position in light of the economic position and budgetary changes already approved.

5. Capital Position (Prudential Indicators)

The Partnership undertakes capital expenditure on long-term assets. These activities may be financed through the application of capital or revenue resources (e.g. capital grants, capital receipts, revenue contributions etc.) or give rise to a borrowing requirement.

This section of the report provides an update on:

- SPT's capital expenditure plans;
- how these plans are financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

The actual capital expenditure forms one of the required prudential indicators.

Table 2 below provides a summary of the revised capital expenditure plans for 2020/21 as approved by the Partnership on 18 September 2020.

Table 2	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Capital Programme approved by the Partnership on 6 March 2020	37,917	22,905	60,822
Amendments approved by the Strategy & Programmes Committee	0	(2,643)	(2,643)
Revised Capital Programme as at 18 September 2020	**37,917**	**20,262**	**58,179**

5.2 Changes to the financing of the capital programme

Table 3 below provides a summary of the available capital funding for 2020/21 as approved by the Partnership on 6 March 2020.

Table 3	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Scottish Government general capital grant	0	15,300	15,300
Scottish Government specific capital grants	55,184	0	55,184
Other grants and contributions	0	50	50
Revenue contribution to the capital programme	0	1,000	1,000
Transfer from Subway Infrastructure Fund (General Fund - Earmarked Reserve)	0	4,000	4,000
Available capital funding 2020/21	**55,184**	**20,350**	**75,534**

Subsequently, the profile of the Scottish Government specific grant funding for Subway Modernisation has been revised following discussions with Transport Scotland. As a result, no funding will now be received in 2020/21.

As reported to the Partnership meeting on 26 June 2020, the measures put in place to protect public health in response to the Covid-19 pandemic have had a significant impact on SPT's income in 2020/21. As a result, the planned revenue contribution to the capital programme of £1m in 2020/21 will not now be progressed.

There has been a reduction of £1.445m in the revised 2020/21 funding (General Capital) in relation to the transfer required from the Subway Infrastructure Fund.

Table 4 below provides a summary of the revised capital funding available for 2020/21 as approved by the Partnership on 18 September 2020.

Table 4	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Scottish Government general capital grant	0	15,300	15,300
Scottish Government specific capital grants	0	0	0
Other grants and contributions	0	50	50
Transfer from Subway Infrastructure Fund (General Fund - Earmarked Reserve)	0	2,555	2,555
Available capital funding 2020/21	**0**	**17,905**	**17,905**

5.3 Revised capital programme position

Table 5 below provides a summary of the capital position as approved by the Partnership on 18 September 2020.

Table 5	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Revised Capital Programme as at 18 September 2020	37,917	20,262	58,179
Available capital funding 2020/21	0	17,905	17,905
Transfer from Capital Grants Unapplied Account	37,917	0	37,917
Projected variance	**0**	**2,357**	**2,357**

It is anticipated that the measures put in place in response to the Covid-19 pandemic will continue to affect the delivery of projects in 2020/21 and that further budget amendments will be necessary.

Further work to quantify and manage risk, advance savings and re-phase existing projects is being undertaken to balance spend against budget.

5.4 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

5.4.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) is the amount of capital expenditure to be financed by means other than grants or capital receipts. As can be seen from Table 6 below, there has been no change in the CFR, reflecting the balanced changes in the Capital Programme and the Available Funding.

Table 6	2020/21 Original Forecast as at 06/03/2020 £000	2020/21 Revised Forecast as at 18/09/2020 £000
Capital Programme	60,822	58,179
Available Funding	75,534	17,905
Transfer from / (to) Capital Grants Unapplied Account	(17,267)	37,917
Transfer from Capital Fund	2,555	2,357
Capital Financing Requirement	**0**	**0**

5.4.2 Portfolio position

SPT's treasury portfolio position is summarised in Tables 7 and 8 below.

Table 7 Treasury Investments	2020/21 Original Forecast £000	2020/21 Revised Forecast £000
Banks and building societies (rated)		
Managed in-house	166,228	150,000
Managed externally	0	0
Total Investments	**166,228**	**150,000**

The original forecast for investments was produced before the actual year-end position was known for 2019/20. The opening position for 2020/21 was actually £27m more than forecast mainly due to an underspend on the capital programme.

The revised forecast for investments is based on current income and expenditure information projected to the end of the financial year. Whilst formulising the revised projections, previous assumptions have been reviewed including the significant impact of the Covid-19 pandemic on SPT's income and potential spend-risk on the capital programme.

Table 8 shows the external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 8 External Debt	2020/21 Original Forecast £000	2020/21 Revised Forecast £000
Gross debt at 1 April	0	0
Expected change in gross debt	0	0
Gross debt at 31 March	**0**	**0**
The Capital Financing Requirement	**0**	**0**
Under / (over) borrowing	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.

5.4.3 Operational Boundary for External Debt and Authorised Limit for External Debt

The Operational Boundary for External Debt 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.

The Authorised Limit for External Debt 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. This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35 (1) of the Local Government in Scotland Act 2003.

As can be seen from Table 9 below, the Operational Boundary and Authorised Limit on External Debt have not changed from the original estimates.

Table 9	2020/21 Original Forecast £000	2020/21 Revised Forecast £000
Operational Boundary	50,000	50,000
Authorised Limit for External Debt	55,000	55,000

6. Investment Strategy

The Treasury Management Strategy 2020/21 was reported to the Strategy & Programmes Committee on 7 February 2020 and subsequently approved by the Partnership on 6 March 2020.

In terms of investment policy, the 2020/21 Strategy states that "SPT's investment priorities will be security first, liquidity second and then return." During the first six months of 2020/21 this investment policy was followed in full.

In terms of permitted investments, SPT's policy is governed by the Investment Regulations (Code on the Investment of Money by Local Authorities). The 2020/21 Strategy lists the types of investments which can be used and sets appropriate limits for the amount that can be held in each investment type. During the first six months of 2020/21 this policy was followed in full.

In terms of credit rating criteria, SPT applies the service provided by our treasury advisors, Link Asset Services, for choosing investment counterparties. This service employs a modelling approach utilising credit ratings from the three main credit rating agencies supplemented by additional market data. During the first six months of 2020/21 this credit rating policy was followed in full and there were no liquidity difficulties.

In terms of counterparty limits the 2020/21 Strategy set these 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; and
- To allow for temporary operational circumstances, there is a tolerance level of 2% of the balance held with each counterparty.

During the first six months of 2020/21 this policy was followed in full.

The approved Counterparty List for 2020/21 is shown at Appendix 1, with updated credit ratings. During the first six months of 2020/21, SPT has only held investment balances with approved UK institutions.

7. Investment Outturn

The result of the investment strategy undertaken by SPT to Period 7 (ending 10 October 2020) is shown in the Table 10 below.

Table 10	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	194	0.00	-0.06%	Instant Access
Account 2	27,143	0.42	-0.06%	95 Day Notice
Account 3	872	0.27	-0.06%	Instant Access
Account 4	27,204	0.27	-0.06%	Instant Access
Account 5	7,647	0.51	-0.06%	95 Day Notice
Account 6	37,000	1.10	-0.06%	Fixed Term
Account 7	5,002	0.09	-0.06%	Instant Access
Account 8	16	0.00	-0.06%	Instant Access
Account 9	19	0.25	-0.06%	31 Day Notice
Account 10	10,449	0.17	-0.06%	Instant Access
Account 11	25,599	0.38	-0.06%	95 Day Notice
Account 12	4	0.20	-0.06%	Instant Access
Account 13	4	0.45	-0.06%	31 Day Notice
Account 14	29,912	0.76	-0.06%	95 Day Notice

*The benchmark return is the 7-day LIBID uncompounded.

SPT earned interest of £0.543m during the first six months of 2020/21, against budgeted income of £0.753m. This reflects the significant reduction in rates of return being earned in 2020/21 than originally anticipated following the changes in Base Rate in March 2020 in response to the Covid-19 pandemic.

The overall average rate of return obtained equates to 0.57% per annum, which exceeds the benchmark by 0.63% per annum and the prevailing Base Rate by 0.47%. The benchmark return shown in Table 10 was actually negative due to the Base Rate being so low.

The Partnership holds a number of investment accounts with balances below £1,000. This is in order to maintain relationships with counterparties which currently offer low rates of return or do not meet the minimum acceptable credit criteria. Retaining these accounts ensures quick access at the point that these accounts become competitive or regain the minimum acceptable credit criteria. These accounts have not been shown in Table 10 on the basis of materiality.

Investments are placed at available rates at a point in time in accordance with SPT's priorities of security, liquidity and return as well as available counterparty balances whilst taking into account forecast cash flow requirements. Consequently, Table 10 reflects the impact of timing issues in relation to maximising investment returns.

8. Borrowing

As stated previously SPT had no requirement for borrowing in the first six months of 2020/21 and remains debt free.

9. Conclusion

During the first six months of 2020/21 SPT has operated within the Treasury Limits and Prudential Indicators set out in the Treasury Management Strategy 2020/21. All treasury management operations have also been conducted in full compliance with SPT's Treasury Management Practices.

10. Committee action

The Committee is recommended to consider this report and to:

(a) note the content of this report; and to

(b) recommend to the Partnership meeting of 11 December 2020 approval to revise the counterparty limits as detailed in Section 4 of this report.

11. Consequences

Policy consequences	*None.*
Legal consequences	*All legislation and regulations are adhered to.*
Financial consequences	*As detailed in the report.*
Personnel consequences	*None.*
Equalities consequences	*None.*
Risk consequences	*As detailed in the report.*

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.*

SPT's Counterparty List 2020/21

Investment balances have been held with the following counterparties so-far during financial year 2020/21:

Counterparty Institution	Country / Classification	Band
Bank of Scotland PLC	UK	Red
Barclays Bank PLC	UK	Red
HSBC UK Bank PLC	UK	Orange
Santander UK PLC	UK	Red
Nationwide Building Society	UK Building Societies	Red
The Royal Bank of Scotland Plc	Part Nationalised Banks	Blue

Investment balances could also potentially be held with the following counterparties during financial year 2020/21:

Counterparty Institution	Country / Classification	Band
Abbey National Treasury Services 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
Lloyds Bank Corporate Markets Plc	UK / Bank	Red
Lloyds Bank Plc	UK / Bank	Red
NatWest Markets Plc	UK / Bank	Green
Standard Chartered Bank	UK / Bank	Red
Sumitomo Mitsui Banking Corporation Europe Ltd	UK / Bank	Red
National Westminster Bank PLC	UK / Part Nationalised Bank	Blue
Coventry Building Society	UK / Building Society	Red
Leeds Building Society	UK / Building Society	Green
Skipton Building Society	UK / Building Society	Green
Yorkshire Building Society	UK / Building Society	Green

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)