Committee report

Annual Treasury Management Report 2021/2022

Committee Strategy & Programmes

Date of meeting 9 September 2022 **Date of report** 24 August 2022

Report by Director of Finance & Corporate Support

1. Object of report

To report on the treasury management activities and the actual prudential and treasury management indicators for 2021/2022.

2. Background

2.1 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 2021/2022. This report meets the requirements of both the CIPFA Treasury Management in The Public Services: Code of Practice and Cross-sectoral Guidance Notes (the “Code of Practice”) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the “Prudential Code”).

2.2 SPT has adopted the Code of Practice and fully complies with the requirements of the 2017 Edition.

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, including 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.”

2.3 During financial year 2021/2022 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year to Partnership of 12 March 2021 https://www.spt.co.uk/media/krppxmyi/p120321_agenda8.pdf
- a mid-year treasury update report to Strategy & Programmes of 26 November 2021 https://www.spt.co.uk/media/x4cjuc0x/sp261121_agenda7.pdf
- an annual report following the end of the year describing the activity compared to the strategy (this report).

2.4 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.

2.5 CIPFA published a revised Code of Practice and Prudential Code on 20 December 2021. In accordance with CIPFA's expectations:

- SPT will fully implement the requirements of the Code of Practice (2021 Edition) in financial year 2023/24.
- SPT has fully adopted the ongoing principles of the Prudential Code and will fully introduce the reporting requirements of the 2021 Edition in financial year 2023/24 (these include changes in capital strategy, prudential indicators and investment reporting).

Additionally, SPT does not borrow to invest primarily for financial return and therefore meets this immediate requirement of the Prudential Code (2021 Edition).

3. The Economy in 2021/2022

3.1 The UK economy continued to recover in 2021/2022 from the effects of the Covid-19 pandemic but growth is slowing. Inflation is rising significantly due to supply side shortages, labour shortages, commodity price increases, the economic impact of Russia's invasion of Ukraine and subsequent sanctions.

3.2 With most of the economy now opened up and nearly back to business-as-usual, annual economic growth (GDP) was estimated to have risen by 7.4% in 2021 having fallen by 9.3% in 2020. However, growth is slowing with UK GDP estimated to have risen by 0.8% in 2022 Q1 (January to March) and is now projected to enter recession from 2022 Q4 (October to December). This is a reflection of the fall in real incomes due to higher global energy and tradable goods prices, as well as constraints on output from ongoing shortages of labour and goods.

3.3 Consumer Price Index (CPI) inflation increased significantly from 1.5% in April 2021 to 7.0% in March 2022. During the financial year, CPI inflation was well above the UK Government's 2% target reflecting the large increases in global energy and tradable goods prices, the latter of which is due to the shift in global demand towards durable goods and to supply chain disruptions.

At the time of producing this report, CPI inflation has increased to 10.1% and is expected to continue to increase to just over 13% in 2022 Q4 (October to December) and to remain at very elevated levels throughout much of 2023, before falling to the 2% target two years ahead.

3.4 The unemployment rate has fallen over the financial year, from 4.9% in the three months to April 2021 to 3.7% in the three months to March 2022. The labour market has remained tight, with vacancies at historically high levels and, together with the high levels of CPI inflation, this is contributing to increased pressure on wage growth. The unemployment rate is expected to remain around its current level in the near-term but in the longer-term, as demand continues to slow, firms are expected to reduce their workforce, which will ease the tightness in the labour market and increase unemployment.

3.5 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. That framework recognises that there would be occasions when inflation would depart from the target as a result of shocks and disturbances.

3.6 During 2020/21 the MPC increased Bank Rate from 0.10% in April 2021 to 0.75% in March 2022 to help inflation return to the target. At the time of producing this report, Bank Rate has increased to 1.75% and is expected to increase further in the short-term.

3.7 In regard to its' programme of Quantitative Easing, the MPC began to reduce the stock of both UK government bonds and corporate bonds. These sales would be conducted so as not to disrupt the functioning of financial markets, in a relatively gradual and predictable manner over a period of time.

3.8 The MPC plans to take the actions necessary to return inflation to the 2% target sustainably in the medium-term, in line with its remit. The scale, pace and timing of any further changes in Bank Rate will reflect the MPC's assessment of the economic outlook and inflationary pressures.

4. Capital Expenditure and Financing

4.1 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.

4.2 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	**2019/20 Actual £000**	**2020/21 Actual £000**	**2021/2022 Actual £000**
Capital Programme expenditure	**36,358**	**23,059**	**25,793**
Capital grants and contributions	36,383	23,059	25,295
Transfers from / (to) reserves	(25)	0	498
Capital Funding	**36,358**	**23,059**	**25,793**

5. Portfolio position

5.1 At the beginning and end of 2021/2022 SPT's treasury investments position was as shown in Table 2 below:

Table 2 Treasury Investments	Principal 31 March 2021 £000	Principal 31 March 2022 £000	Interest Earned £000
Banks and building societies (rated)			
Managed in-house	172,677	178,586	491
Managed externally	0	0	0
Total Treasury Investments	**172,677**	**178,586**	**491**

5.2 All treasury investments mature within one year.

5.3 As can be seen from Table 2, SPT earned interest of £0.491m during 2021/2022. This is a decrease of £0.386m when compared to the interest earned of £0.877m during 2020/21, mainly as a result of the significant fall in investment rates earned in 2021/2022 following the emergency cuts in Base Rate in March 2020 in response to the Covid-19 pandemic.

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

5.5 At the beginning and end of 2021/2022 SPT's non-treasury investments position was as shown in Table 3 below:

Table 3 Non-treasury Investments	Valuation 31 March 2020 £000	Valuation 31 March 2021 £000	Income Earned £000
Investment properties	5,079	5,035	577
Shareholdings in joint venture companies	5	5	0
Total Non-treasury Investments	**5,084**	**5,040**	**577**

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

5.7 At the beginning and end of 2021/2022 SPT's debt position was as shown in Table 4 below:

Table 4 Debt	Principal 31 March 2021 £000	Principal 31 March 2022 £000	Principal Repaid £000	Interest Rate (including expenses) %
Gross borrowing	0	0	0	0

5.8 SPT had no requirement for borrowing during 2021/2022 and remains debt free. The current funding and expenditure profiles to 2024/25 do not require any borrowing.

6. Prudential and Treasury Management Indicators

6.1 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.

6.2 SPT has adopted the 2017 Edition of 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.

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

6.4 During financial year 2021/2022, SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2021/2022.

7. Annual Investment Strategy

7.1 The Annual Investment Strategy for 2021/2022 was reported to and approved by the Partnership on 12 March 2021.

Investment Policy

The 2021/2022 Strategy states that “SPT’s investment priorities will be security first, liquidity second and then return.”

Permitted Investments

The 2021/2022 Strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Credit Rating Criteria

The 2021/2022 Strategy lists the potential institutions permitted to be used by SPT.

SPT applies the service provided by our treasury management advisors, Link Group. This service employs a modelling approach utilising credit ratings from the main credit rating agencies supplemented by additional market data, to classify counterparties into bands which indicate the relative credit rating and suggested duration for investments.

Counterparty Limits

The 2021/2022 Strategy set out counterparty limits 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.

Additionally, SPT has set an individual transaction limit of £20m for the placing of investments.

7.2 The Annual Investment Strategy for 2021/2022 was followed in full.

8. Investment Outturn

8.1 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 12 March 2021.

8.2 The result of the Annual Investment Strategy for 2021/2022 is shown in Table 5 below:

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	1,577	0.09	0.14	Instant Access
Account 2	23,462	0.25	0.14	95 Day Notice
Account 3	872	0.01	0.14	Instant Access
Account 4	24,117	0.01	0.14	Instant Access
Account 5	16,923	0.26	0.14	Fixed Term
Account 6	5,008	0.19	0.14	Instant Access
Account 7	16	0.00	0.14	Instant Access
Account 8	19	0.20	0.14	31 Day Notice
Account 9	10,469	0.15	0.14	Instant Access
Account 10	30,754	0.37	0.14	35 Day Notice
Account 11	10,019	0.37	0.14	95 Day Notice
Account 12	3,006	0.05	0.14	Instant Access
Account 13	5,015	0.32	0.14	31 Day Notice
Account 14	46,003	0.42	0.14	95 Day Notice
Account 15	1,154	0.11	0.14	Fixed Term

* The benchmark return is the backward-looking 7-day compounded SONIA

8.3 The publication of official LIBOR figures, and therefore related LIBID calculations, ceased in December 2021. SPT has adopted SONIA (Sterling Overnight Index Average) as being the most suitable replacement investment benchmark for LIBID.

SONIA is the risk-free rate for sterling markets administered by the Bank of England. It is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

SPT will use an investment benchmark to assess the investment performance of its investment portfolio of backward-looking 7-day compounded SONIA.

8.4 The overall average rate of return for 2021/2022 equates to 0.28% per annum, which exceeded the benchmark by 0.14% per annum.

8.5 SPT 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 5 on the basis of materiality.

8.6 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 5 reflects the impact of timing issues in relation to maximising investment returns.

9. Control of Interest Rate Risk

9.1 The expectation for interest rates within the 2021/2022 Treasury Management Strategy was that the Bank of England's Monetary Policy Committee (MPC) would maintain Bank Rate at 0.10% throughout the financial year and to continue its' existing programme of Quantitative Easing. The Government also provided funding to local authorities to pass on to businesses to help with the impact of the lockdowns in response to the Covid-19 pandemic.

This meant that for most of the financial year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained low until towards early 2022 when inflation concerns indicated that the MPC would need to increase interest.

9.2 While SPT has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

9.3 Consequently, SPT has taken a pragmatic approach to investing and value was sought by placing short-term investments.

10. Conclusion

10.1 During the financial year 2021/2022 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2021/2022.

10.2 The Annual Investment Strategy for 2021/2022 was followed in full. Looking ahead, given the current economic environment it is necessary to continue close monitoring of all SPT's Treasury decisions.

11. Committee action

The Committee is asked to:

(i) note the content of this report; and

(ii) approve the prudential and treasury management indicators for 2021/2022 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.*
Climate Change, Adaptation & Carbon consequences	*None.*

Name	Neil Wylie	**Name**	Valerie Davidson
Title	**Director of Finance & Corporate Support**	**Title**	**Chief Executive**

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

APPENDIX 1

Prudential and treasury management indicators	2020/21 Actual £000	2021/2022 Forecast £000	2021/2022 Actual £000
		Note (1)	
Prudential indicators			
Capital Expenditure	23,059	39,353	25,793
Ratio of financing costs to net revenue stream	-2%	-1%	-1%
Gross borrowing requirement Note (2)			
Brought forward 1 April	0	0	0
Carried forward 31 March	0	0	0
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	50,000	50,000	50,000
Authorised Limit	55,000	55,000	55,000
Principal sums invested > 365 days Note (3)			
Indicator	0	50,000	0
Authorised Limit	50,000	50,000	50,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2021/2022.

Note (2) The total of external borrowings. SPT is currently debt free.

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