Committee report

Annual Treasury Management Report 2017/18

Committee Strategy & Programmes

Date of meeting 7 September 2018 **Date of report** 28 August 2018

Report by Assistant Chief Executive (Business Support)

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 2017/18. 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 2017/18 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year (Strategy & Programmes, 17 March 2017)
- a mid-year treasury update report (Strategy & Programmes, 24 November 2017)
- 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 "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" and a revised "The Prudential Code for Capital Finance in Local Authorities". The issue of revised Codes at such a late stage in the financial year has meant that SPT will not be able to fully implement both Codes until 2019/20.

3. The Economy and Interest Rates in 2017/18

Economic growth (GDP) was estimated to have increased by 1.7% in calendar year 2017, slightly below the 1.8% growth in 2016. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum vote for Brexit, feeding increases in the cost of imports into the economy. The expectation is for GDP to continue to grow at a modest pace over the next few years.

The unemployment rate has fallen to 4.2% in January 2018, its lowest level since 1975, whilst pay growth has continued to pick up. The expectation is for pay growth to rise further in response to the tightening labour market.

Consumer Price Index (CPI) inflation has fallen from 2.7% in April 2017 to 2.5% in March 2018, having peaked at 3.1% in November 2017. Inflation has been pushed above the UK Government's 2% target by the increase in import prices that resulted from the past devaluation of sterling. The expectation is for inflation to ease further in the short term although to remain above the 2% target.

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 2 November 2017, the MPC reacted to the economic outlook by raising Bank Rate from 0.25% to 0.50%, the first rate rise in 10 years*.

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

Developments regarding the UK's withdrawal from the European Union remain the most significant influence on, and source of uncertainty about, the economic outlook. In such exceptional circumstances, the MPC's remit specifies that it must balance any trade-off between the speed at which it intends to return inflation sustainably to the target and the support that monetary policy provides to jobs and activity.

*At its meeting on the 1st of August 2018 the MPC increased the Bank Rate to 0.75%. No further increases are anticipated in the current financial year.

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	**2015/16 Actual £000**	**2016/17 Actual £000**	**2017/18 Actual £000**
Capital Programme expenditure	**54,595**	**59,648**	**39,960**
Capital grants and contributions	26,333	40,761	39,946
Revenue contribution to the capital programme	5,596	1,800	0
Subway fund utilisation	16,969	17,087	0
Transfers from reserves (including Unapplied Capital Grants)	5,697	0	14
Borrowings	0	0	0
Capital Funding	**54,595**	**59,648**	**39,960**

5. Overall Treasury Position

At the beginning and end of 2017/18 SPT's debt position was as shown in Table 2 below:

Table 2	**Principal 31 March 2017 £000**	**Principal 31 March 2018 £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 2020/21 do not require any borrowing.

At the beginning and end of 2017/18 SPT's investment position was as shown in Table 3 below:

Table 3	Principal 31 March 2017 £000	Principal 31 March 2018 £000	Interest Earned £000
Total investments	88,140	168,153	664

As can be seen from Table 3, SPT earned interest of £664k during 2017/18. This is an increase of £34k when compared to the interest earned of £630k during 2016/17, mainly as a result of the increase in the level of investment balances held during 2017/18.

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 2017/18 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2017/18.

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

7. Annual Investment Strategy

The Annual Investment Strategy for 2017/18 was reported to and approved by the Strategy & Programmes Committee on 17 March 2017.

Investment Policy

The 2017/18 strategy states that "SPT's investment priorities will be security first, liquidity second and then return."

Types of Investments

The 2017/18 strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Counterparties

The 2017/18 strategy lists the potential institutions permitted to be used by SPT.

Creditworthiness

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 2017/18 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 2017/18 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 Strategy & Programmes Committee on 17 March 2017.

The result of the Annual Investment Strategy for 2017/18 is shown in Table 4 below:

Table 4	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	10,059	0.44	0.21	Instant Access
Account 2	10,769	0.60	0.21	95 Day Notice
Account 3	5,385	0.74	0.21	Fixed Term
Account 4	12,199	0.40	0.21	Instant Access
Account 5	272	0.37	0.21	Instant Access
Account 6	11,137	0.46	0.21	32 Day Notice
Account 7	29,323	0.62	0.21	95 Day Notice
Account 8	5,224	0.37	0.21	Instant Access
Account 9	15,070	0.55	0.21	95 Day Notice
Account 10	17	0.03	0.21	Instant Access
Account 11	0	0.22	0.21	95 Day Notice
Account 12	1,377	0.25	0.21	Instant Access
Account 13	2,089	0.40	0.21	31 Day Notice
Account 14	17,451	0.66	0.21	95 Day Notice

* The benchmark return is the 7 day LIBID uncompounded

The overall average rate of return equates to 0.55%, which exceeds the benchmark by 0.34% 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. Conclusion

During the financial year 2017/18 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2017/18.

The Annual Investment Strategy for 2017/18 was followed in full.

10. Committee action

The Committee is recommended to:

(a) note the content of this report; and

(b) note the prudential and treasury management indicators for 2017/18 as detailed in Appendix 1.

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*

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Title **Assistant Chief Executive (Business Support)**

Name Gordon Maclennan
Title **Chief Executive**

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Appendix 1

Prudential and treasury management indicators	2016/17 Actual £000	2017/18 Forecast £000	2017/18 Actual £000
		Note (1)	
Prudential indicators			
Capital Expenditure	59,648	85,355	39,960
Ratio of financing costs to net revenue stream	-1%	-1%	-3%
Net borrowing requirement / (net investments) Note (2)			
Brought forward 1 April	(96,568)	(83,196)	(88,140)
Carried forward 31 March	(88,140)	(64,007)	168,153
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	20,000	30,000	30,000
Authorised Limit	22,000	33,000	33,000
Principal sums invested > 365 days Note (3)			
Indicator	0	0	0
Authorised Limit	35,000	25,000	25,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2017/18.

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.