Committee report

Mid-Year Treasury Management Report 2019/20

Committee Strategy and Programmes

Date of meeting 22 November 2019 **Date of report** 13 November 2019

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

Economic growth (GDP) in volume terms has fallen by 0.2% in Quarter 2 (April to June) 2019 and is now expected to rise by 0.2% in Quarter 3. Brexit uncertainties have continued to weigh on business investment, although consumption growth has remained resilient, supported by growth in real household income. The trade dispute between the United States and China has intensified, and the outlook for global growth has weakened which is weighing on UK exports. The expectation is for GDP to grow at 1.50% per annum on average over the next three years.
CPI inflation has fallen from 2.1% in April 2019 to 1.7% in September, and is expected to remain slightly below the 2% Government target in the near term.

Unemployment has remained low at just under 4% during 2019 and the labour market appears to remain tight. Annual pay growth has strengthened further to the highest rate in over a decade which is contributing to domestic inflationary pressures.

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 18 September 2019 the MPC voted unanimously to maintain 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, conditional upon greater clarity that the economy is on a path to a smooth Brexit, and assuming some recovery in global growth.

The MPC recognises 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 response of monetary policy will depend on the balance of the effects of Brexit on demand, supply and the sterling exchange rate. SPT will continue to monitor this matter and will factor into future years' treasury management strategies, as more information becomes available.

On 9 October 2019 the Public Works Loan Board (PWLB) unexpectedly announced an increase of 1.00% in the margin over gilt yields charged for new borrowing. This may mean that the PWLB is no longer considered as the lender of first choice for local government. Taking this one-off change into account, the longer term trend is still for PWLB borrowing rates to rise gradually.

On 8 November 2019, ratings agency Moody's signalled that it may downgrade its credit rating on UK government debt when it changed the outlook from "stable" to "negative". This decision was driven by two factors: UK institutions have weakened as they have struggled to cope with the magnitude of policy challenges that they currently face, including those that relate to fiscal policy; and the UK's economic and fiscal strength are likely to be weaker going forward and more susceptible to shocks than previously assumed.

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-19**	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**	**Sep-21**	**Dec-21**	**Mar-22**
0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00

4. Treasury Management Strategy Update

The Treasury Management Strategy 2019/20, including the Annual Investment Strategy, was approved by the Partnership on 8 March 2019.

There are no 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 2019/20 as approved by the Strategy & Programmes Committee on 30 August 2019.

Table 2	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Capital Programme approved by the Partnership on 8 March 2019	47,372	24,785	72,157
Amendments approved by the Strategy & Programmes Committee	-3,333	418	-2,915
Revised Capital Programme as at 30 August 2019	**44,039**	**25,203**	**69,242**

5.2 Changes to the financing of the capital programme

Table 3 below provides a summary of the available capital funding for 2019/20 as approved by the Partnership on 8 March 2019.

Table 3	Subway Modernisation £000	General Capital £000	Total £000
Scottish Government general capital grant	-	23,131	23,131
Scottish Government specific capital grants	47,372	-	47,372
Available capital funding 2019/20	**47,372**	**23,131**	**70,503**

Subsequently, the Scottish Government General Capital grant award has been confirmed at £23.1m which is a reduction of £0.031m compared to the previously estimated value. There has also been a small increase in the contributions available for General Capital, but these have been equalled by a corresponding increase in planned expenditure (approved by the Strategy & Programmes Committee on 30 August 2019).

There has been a reduction of £3.333m in the revised funding required in 2019/20 for Subway Modernisation.

Table 4 below provides a summary of the revised capital funding available for 2019/20 as approved by the Strategy & Programmes Committee on 30 August 2019.

Table 4	Subway Modernisation £000	General Capital £000	Total £000
Scottish Government general capital grant	-	23,100	23,100
Scottish Government specific capital grants	44,039	-	44,039
Other grants and contributions	-	3	3
Available capital funding 2019/20	**44,039**	**23,103**	**67,142**

5.3 Revised capital programme position

Table 5 below provides a summary of the capital position as approved by the Strategy & Programmes Committee on 30 August 2019.

Table 5	Subway Modernisation £000	General Capital £000	Total £000
Revised Capital Programme as at 30 August 2019	44,039	25,203	69,242
Available capital funding 2019/20	44,039	23,103	67,142
Projected variance	**-**	**2,100**	**2,100**

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 Net Borrowing Requirement

There are a number of prudential indicators that are reported to members each year in relation to debt:

- Capital Financing Requirement;
- Operational Boundary for External Debt and Authorised Limit for External Debt;
- Net Borrowing Requirement.

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	**2019/20 Original Forecast as at 08/03/19 £000**	**2019/20 Revised Forecast as at 30/08/19 £000**
Capital Programme	72,157	69,242
Available Funding	70,503	67,142
Capital Receipts Reserve	1,654	2,100
Capital Financing Requirement	0	0

5.4.2 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 7 below, the Operational Boundary and Authorised Limit on External Debt have not changed from the original estimates.

Table 7	**2019/20 Original Forecast as at 08/03/19 £000**	**2019/20 Revised Forecast as at 30/08/19 £000**
Operational Boundary	50,000	50,000
Authorised Limit for External Debt	55,000	55,000

5.4.3 Net Borrowing Requirement

The Net Borrowing Requirement is a key control over the treasury activity to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose.

Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. As can be seen from Table 8 below, SPT is currently a net investor.

Table 8	2019/20 Original Forecast as at 08/03/19 £000	2019/20 Revised Forecast as at 30/08/19 £000
Capital Financing Requirement	0	0
Less Investments	104,303	150,000
Net Borrowing Requirement	-104,303	-150,000

The original forecast for investments was produced before the actual year-end position was known for 2018/19. The opening position for 2019/20 was actually £22m more than forecast mainly due to an underspend on the capital programme, an increased contribution to the Subway Fund and a one-off capital receipt.

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 and potential spend-risk has been taken into account.

6. Investment Strategy

The Treasury Management Strategy 2019/20 was reported to and approved by the Partnership on 8 March 2019.

In terms of investment policy, the 2019/20 Strategy states that “SPT’s investment priorities will be security first, liquidity second and then return.” During the first six months of 2019/20 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 2019/20 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 2019/20 this policy was followed in full.

In terms of creditworthiness, SPT applies the service provided by our treasury advisors, Link Asset Services, for choosing investment counterparties. This creditworthiness 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 2019/20 this creditworthiness policy was followed in full and there were no liquidity difficulties.

In terms of counterparty limits the 2019/20 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 2019/20 this policy was followed in full.

The approved Counterparty List for 2019/20 is detailed at Appendix 1. During the first six months of 2019/20, SPT has only held investment balances with UK institutions.

7. Investment Outturn

The result of the investment strategy undertaken by SPT to Period 7 (ending 12 October 2019) is shown in the Table 9 below.

Table 9	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	261	0.59	0.57	Instant Access
Account 2	25,000	1.01	0.57	95 Day Notice
Account 3	21,750	0.80	0.57	Instant Access
Account 4	828	0.80	0.57	Instant Access
Account 5	1,606	0.80	0.57	32 Day Notice
Account 6	36,601	1.10	0.57	95 Day Notice
Account 7	15,000	1.25	0.57	Fixed Term
Account 8	0	0.65	0.57	Instant Access
Account 9	714	0.85	0.57	Instant Access
Account 10	714	0.90	0.57	31 Day Notice
Account 11	10,510	0.72	0.57	Instant Access
Account 12	25,333	1.05	0.57	95 Day Notice
Account 13	0	0.20	0.57	Instant Access
Account 14	0	0.79	0.57	95 Day Notice
Account 15	4	0.40	0.57	Instant Access
Account 16	4	0.65	0.57	31 Day Notice
Account 17	27,492	1.01	0.57	95 Day Notice

*The benchmark return is the 7 day LIBID uncompounded.

SPT earned interest of £0.889m during the first six months of 2019/20, against budgeted income of £0.646m.

The overall average rate of return obtained equates to 1.01% per annum, which exceeds the benchmark by 0.44% per annum.

As can be seen from Table 9, 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.

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 9 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 2019/20 and remains debt free.

9. Conclusion

During the first six months of 2019/20 SPT operated within the Treasury Limits and Prudential Indicators set out in the Treasury Management Strategy 2019/20.

10. Committee action

The Committee is recommended to consider and note the content 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
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SPT's Counterparty List 2019/20

Investment balances have been held with the following counterparties so far during financial year 2019/20

Counterparty Institution	Country / Classification	Band
Bank of Scotland PLC	UK	Orange
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 2019/20

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	Orange
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)