Strategy & Programmes Committee

Annual Treasury Management Report 2022/2023

Date of meeting 8 September 2023 **Date of report** 21 August 2023

Report by Director of Finance & Corporate Support

1. Object of report

To update the Committee on the treasury management activities and the actual Prudential and Treasury Indicators for 2022/2023.

2. Background to 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 2022/2023. 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”).

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.”

During financial year 2022/2023 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year to Partnership of 18 March 2022 spt.co.uk/media/lr2iuhl2/p180322_agenda9.pdf
- a mid-year treasury update report to Strategy & Programmes of 25 November 2022 spt.co.uk/media/obweua0r/sp251122_agenda6.pdf
- 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.

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 2023/2024.
- 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 2023/2024 (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 2022/2023

The UK economy is facing a very challenging outlook. Economic activity is losing momentum. Inflationary pressures are elevated and have been more persistent than expected. Unemployment remains at a historically low levels but is expected to rise gradually.

Annual economic growth (GDP) was estimated to have risen by 4.1% in 2022 having risen by 7.6% in 2021. However, growth is slowing with UK GDP estimated to have risen by 0.1% in 2023 Q1 (January to March) and is expected to be 0.2% in 2023 Q2 and Q3. This is a reflection of the fall in real household incomes, and hence consumer spending, as well as constraints on output from ongoing shortages of labour and goods.

Consumer Price Index (CPI) inflation increased from 9.0% in April 2022 to 10.1% in March 2023, having peaked at 11.1% in October 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. At the time of producing this report, CPI inflation has fallen to 6.8% due to household energy bills stabilising and food price inflation appearing to have peaked. CPI inflation is expected to continue to fall to be around 5% by the end of 2023. Thereafter, CPI inflation is expected to fall more gradually, reaching the 2% target by 2025 Q2 (April to June).

The unemployment rate has remained at historically low levels during the financial year, being 3.8% in the three months to April 2022 and 3.9% in the three months to March 2023. The labour market remains tight by historical standards, although there are signs that it has started to loosen. However, pay growth has been stronger than expected. The unemployment rate is expected to rise gradually to around 5% by 2026 Q3 (July to September).

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. During 2022/2023, the MPC increased Bank Rate from 0.75% in April 2022 to 4.25% in March 2023 in response to the elevated inflationary pressures. At the time of producing this report, Bank Rate has risen further to 5.25% and is expected to peak at 5.50% in 2023 Q3 before falling back as inflationary pressures subside.

The MPC judges that there are considerable uncertainties around the outlook and if there were to be evidence of more persistent inflationary pressures then further tightening in monetary policy would be required.

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	**2020/2021 Actual £000**	**2021/2022 Actual £000**	**2022/2023 Actual £000**
Capital Programme expenditure	**23,059**	**25,793**	**37,111**
Capital grants and contributions	23,059	25,295	35,060
Transfers from / (to) reserves	0	498	2,051
Capital Funding	**23,059**	**25,793**	**37,111**

5. Portfolio position

At the beginning and end of 2022/2023 SPT's treasury investments position was as shown in Table 2 below:

Table 2 Treasury Investments	**Principal 31 March 2022 £000**	**Principal 31 March 2023 £000**	**Interest Earned £000**
Deposits with UK banks and building societies (rated)			
Managed in-house	178,586	164,555	3,919
Managed externally	0	0	0
Total Treasury Investments	**178,586**	**164,555**	**3,919**

All treasury investments mature within one year.

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.

At the beginning and end of 2022/2023 SPT's non-treasury investments position was as shown in Table 3 below:

Table 3 Non-treasury Investments	Valuation 31 March 2021 £000	Valuation 31 March 2022 £000	Income Earned £000
Investment properties	5,035	5,675	577
Shareholdings in joint venture companies	5	5	0
Total Non-treasury Investments	**5,040**	**5,680**	**577**

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

At the beginning and end of 2022/2023 SPT's debt position was as shown in Table 4 below:

Table 4 External Debt	Principal 31 March 2022 £000	Principal 31 March 2023 £000	Principal Repaid £000	Interest Rate (including expenses) %
Gross borrowing	0	0	0	0

SPT had no requirement for borrowing during 2022/2023 and remains debt free. The current funding and expenditure profiles to 2024/25 do not require any borrowing.

6. Prudential and Treasury 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 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 Indicators to ensure that treasury activities are kept within authorised limits.

The Prudential and Treasury Indicators are shown in Appendix 1.

During financial year 2022/2023, SPT operated within the Prudential and Treasury Indicators set out in the Treasury Management Strategy 2022/2023.

7. Annual Investment Strategy

The Annual Investment Strategy for 2022/2023 was reported to and approved by the Partnership on 18 March 2022.

This was subsequently updated through the Mid-Year Treasury Management Report 2022/2023 approved by the Strategy & Programmes Committee on 25 November 2022, as follows:

- the Debt Management Office (DMO) was added to the approved Counterparty List;
- the Permitted Investment Types were revised to include term deposits with the Debt Management Account Deposit Facility (DMADF), administered by the DMO; and
- the Treasury Risks and Mitigations were revised to include term deposits with the DMADF.

Investment Policy

The 2022/2023 Strategy states that "SPT's investment priorities will be security first, liquidity second and then return."

Permitted Investments
The updated 2022/2023 Strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Credit Rating Criteria
The updated 2022/2023 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 2022/2023 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.

The updated Annual Investment Strategy for 2022/2023 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 Partnership on 18 March 2022.

The result of the Annual Investment Strategy for 2022/2023 is shown in Table 5 below:

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return %	Liquidity
Account 1	895	0.99	2.19	Instant Access
Account 2	20,848	0.99	2.19	Instant Access
Account 3	5,707	2.29	2.19	Instant Access
Account 4	25,000	2.49	2.19	95 Day Notice
Account 5	16,154	2.59	2.19	Fixed Term
Account 6	772	0.18	2.19	Instant Access
Account 7	2	0.01	2.19	Instant Access
Account 8	4	0.17	2.19	31 Day Notice
Account 9	16,923	2.56	2.19	Fixed Term
Account 10	1,684	0.82	2.19	Instant Access
Account 11	16,311	1.73	2.19	35 Day Notice
Account 12	6,972	0.92	2.19	95 Day Notice

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return %	Liquidity
Account 13	8,498	1.37	2.19	Fixed Term
Account 14	3,020	1.44	2.19	Instant Access
Account 15	5,057	2.02	2.19	31 Day Notice
Account 16	25,786	2.49	2.19	95 Day Notice
Account 17	9,231	1.94	2.19	Fixed Term
Account 18	17,692	2.96	2.19	Fixed Term

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

SPT earned interest of £3.919m during 2022/2023, against a budgeted income of £1.3m. This is an increase of £3.428m when compared to the interest earned of £0.491m during 2021/2022, mainly as a result of the significant increase in investment rates earned in 2022/2023 following the successive increases in Bank Rate.

The overall average rate of return obtained equates to 2.10% per annum, which is 0.09% per annum below the benchmark.

SPT uses an investment benchmark of backward-looking 7-day compounded SONIA (Sterling Overnight Index Average). 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 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.

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

The expectation for interest rates within the 2022/2023 Treasury Management Strategy was that the Bank of England's Monetary Policy Committee (MPC) would gradually increase Bank Rate from 0.75% in April 2022 to 1.25% by March 2023. However, in response to inflationary pressures, the MPC increased Bank Rate significantly during the financial year ending at 4.25% by March 2023.

This meant that for most of the financial year there was a stepped increase in the investment rates available, although some financial institutions were slower to pass on the changes in Bank Rate to customers and the rates offered reflected the liquidity of the funds held. Rates for fixed term deposits were noticeably higher than for instant access and short-term notice accounts.

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.

Consequently, SPT has taken a pragmatic approach to investing and, whilst continuing to maintain cash balances for liquidity purposes, value was sought by placing fixed term deposits on a rolling basis.

10. Committee action

The Committee is recommended to:

(i) note the content of this report; and

(ii) note the Prudential and Treasury Indicators for 2022/2023 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.*
Climate Change, Adaptation & Carbon consequences	*None.*

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Title	**Director of Finance & Corporate Support**	**Title**	**Chief Executive**

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Prudential and Treasury Management Indicators	**2021/2022 Actual £000**	**2022/2023 Forecast** Note (1) **£000**	**2022/2023 Actual £000**
Prudential Indicators			
Capital Expenditure	25,793	63,256	37,111
Capital Financing Requirement (CFR) as at 31 March	0	0	0
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
Ratio of financing costs to net revenue stream	-1%	-2%	-11%
Treasury Indicators			
Actual External Debt	0	0	0
Operational Boundary for External Debt	50,000	50,000	50,000
Authorised Limit for External Debt	55,000	55,000	55,000
Principal sums invested > 365 days Note (3)			
- Actual	0	50,000	0
- Authorised Limit	50,000	50,000	50,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2022/2023.

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.