Committee report

SPT

Annual Treasury Management Report 2020/21

Committee Strategy & Programmes

Date of meeting 27 August 2021 **Date of report** 17 August 2021

Report by Director of Finance

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 2020/21. 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."

During financial year 2020/21 the reporting requirements were that the Partnership should receive the following:

- an annual treasury strategy in advance of the year (Partnership, 6 March 2020)
- a mid-year treasury update report (Strategy & Programmes, 20 November 2020)
- 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.

3. The Economy in 2020/21

The Covid-19 pandemic and the actions to contain it have continued to affect jobs, incomes and spending in the UK. However, Covid-19 vaccination programmes are under way in a number of countries, including the UK, which has improved the economic outlook.

A Trade and Co-operation Agreement between the UK and EU came into effect on 1 January 2021. The main features of that agreement were as had been anticipated with some barriers to trade (including customs processes and some regulatory requirements) but, subject to rules of origin, no tariffs nor quantitative restrictions on goods traded between the two regions.

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). Annual GDP was estimated to have fallen by 9.8% in 2020, the largest yearly fall on record, reflecting a decline in both demand and supply. However, it is expected to recover strongly to pre-Covid levels over the remainder of 2021 in the absence of most restrictions on domestic economic activity. After 2021, the pace of GDP growth is expected to slow.

Consumer Price Index (CPI) inflation fell slightly from 0.8% in April 2020 to 0.7% in March 2021, having peaked at 1% in July 2020. During the financial year, CPI inflation was well below the UK Government's 2% target reflecting the direct and indirect effects of the Covid-19 pandemic on the economy. CPI inflation is expected to rise to close to the 2% target in the near-term as some of those effects fade before temporarily rising above the 2% target towards the end of 2021, owing mainly to developments in energy prices. However, these transitory developments are expected to have few direct implications for inflation over the medium-term.

The unemployment rate increased steadily over the financial year, from 4.0% in the three months to April 2020 to 4.9% in the three months to March 2021. The extension of the Government's employment support schemes in Budget 2021 is expected to limit significantly the near-term rise in the unemployment rate. Most furloughed employees are expected to return to work when the scheme ends, leading to a peak in the unemployment rate at 5.5% in autumn 2021, before declining gradually as GDP picks up.

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 2020/21 the MPC maintained Bank Rate at 0.10% and continued its' programme of Quantitative Easing. The expectation is that Bank Rate will remain at 0.10% in the near-term.

The outlook for the economy, and particularly the relative movement in demand and supply, remains uncertain. It continues to depend on the evolution of the pandemic, measures taken to protect public health, and how households, businesses and financial markets respond to these developments.

The MPC will continue to monitor the situation closely and will take whatever action is necessary to achieve its remit. The MPC does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

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	**2018/19 Actual £000**	**2019/20 Actual £000**	**2020/21 Actual £000**
Capital Programme expenditure	**58,852**	**36,358**	**23,059**
Capital grants and contributions	58,852	36,383	23,059
Transfers from / (to) reserves	0	(25)	0
Capital Funding	**58,852**	**36,358**	**23,059**

5. Portfolio Position

At the beginning and end of 2020/21 SPT's treasury investments position was as shown in Table 2 below:

Table 2 Treasury Investments	**Principal 31 March 2020 £000**	**Principal 31 March 2021 £000**	**Interest Earned £000**
Banks and building societies (rated)			
Managed in-house	169,174	172,677	877
Managed externally	0	0	0
Total Treasury Investments	**169,174**	**172,677**	**877**

All treasury investments mature within one year.

As can be seen from Table 2, SPT earned interest of £0.877m during 2020/21. This is a decrease of £0.812m when compared to the interest earned of £1.689m during 2019/20, mainly as a result of the significant fall in investment rates earned in 2020/21 following the emergency cuts in Base Rate in March 2020 in response to the Covid-19 pandemic.

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 2020/21 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	5,681	5,079	571
Shareholdings in joint venture companies	5	5	0
Total Non-treasury Investments	**5,686**	**5,084**	**571**

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

At the beginning and end of 2020/21 SPT's debt position was as shown in Table 4 below:

Table 4 Debt	**Principal 31 March 2020 £000**	**Principal 31 March 2021 £000**	**Principal Repaid £000**	**Interest Rate (including expenses) %**
Gross borrowing	0	0	0	0

SPT had no requirement for borrowing during 2020/21 and remains 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 2023/24 do not require any borrowing.

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.

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

During financial year 2020/21, SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2020/21.

7. Annual Investment Strategy

The Annual Investment Strategy for 2020/21 was reported to and approved by the Partnership on 6 March 2020 and, subsequently, updated counterparty limits were approved by the Partnership on 11 December 2020.

Investment Policy

The 2020/21 Strategy states that "SPT's investment priorities will be security first, liquidity second and then return."

Permitted Investments

The 2020/21 Strategy lists the potential cash type instruments and other investments permitted to be used by SPT.

Credit Rating Criteria

The 2020/21 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 2020/21 Strategy, approved by the Partnership on 11 December 2020, set 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.

During 2020/21 some additional flexibility was sought to better manage the level of investment balances across SPT's counterparties. Consequently, the following updated counterparty limits were approved by the Partnership on 11 December 2020:

- 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.

The updated Annual Investment Strategy for 2020/21 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 6 March 2020.

The result of the Annual Investment Strategy for 2020/21 is shown in Table 5 below:

Table 5	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	203	0.00	-0.07%	Instant Access
Account 2	30,769	0.42	-0.07%	95 Day Notice
Account 3	872	0.21	-0.07%	Instant Access
Account 4	23,100	0.21	-0.07%	Instant Access
Account 5	4,117	0.33	-0.07%	95 Day Notice
Account 6	28,923	1.09	-0.07%	Fixed Term
Account 7	1,154	0.03	-0.07%	Fixed Term
Account 8	5,003	0.09	-0.07%	Instant Access
Account 9	16	0.00	-0.07%	Instant Access
Account 10	19	0.18	-0.07%	31 Day Notice
Account 11	12,373	0.16	-0.07%	Instant Access
Account 12	9,827	0.35	-0.07%	35 Day Notice
Account 13	17,723	0.37	-0.07%	95 Day Notice
Account 14	385	0.35	-0.07%	95 Day Notice
Account 15	1,158	0.17	-0.07%	Instant Access
Account 16	1,543	0.41	-0.07%	31 Day Notice
Account 17	35,433	0.65	-0.07%	95 Day Notice

* The benchmark return is the 7 day LIBID uncompounded

The overall average rate of return equates to 0.51%, which exceeds the benchmark by 0.58% per annum and the prevailing Base Rate by 0.41%. The benchmark return shown in Table 5 was actually negative due to the prevailing 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 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 2020/21 Treasury Management Strategy was that the Bank of England's Monetary Policy Committee (MPC) would increase Bank Rate from 0.75% to 1.00% over the course of the financial year. This forecast was invalidated in March 2020 by the emergency measures taken by the MPC in response to the unprecedented situation caused by the Covid-19 pandemic. Bank Rate was cut from 0.75% to 0.10% and this was accompanied by a programme of Quantitative Easing and measures to help businesses access loans from their banks. This meant that for most of the financial year, there was much more liquidity in financial markets than there was demand to borrow resulting in plummeting investment earnings rates. Consequently, SPT has taken a pragmatic approach to investing and value was sought by placing short-term investments.

10. Conclusion

During the financial year 2020/21 SPT operated within the Prudential and Treasury Management Indicators set out in the Treasury Management Strategy 2020/21.

The updated Annual Investment Strategy for 2020/21 was followed in full. Looking ahead, given the current economic uncertainty it is necessary to continue close monitoring of all SPT's Treasury decisions.

11. Committee action

The Committee is requested to consider this report and to:

(a) note the content of this report; and

(b) note the prudential and treasury management indicators for 2020/21 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*

Name	Neil Wylie	**Name**	Valerie Davidson
Title	**Director of Finance**	**Title**	**Acting Chief Executive**

For further information, please contact Stuart Paul, Chief Accountant, on 0141 333 3382.

Prudential and treasury management indicators	2019/20 Actual £000	2020/21 Forecast £000	2020/21 Actual £000
		Note (1)	
Prudential indicators			
Capital Expenditure	36,358	64,333	23,059
Ratio of financing costs to net revenue stream	-2%	-5%	-2%
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	37,000	50,000	0
Authorised Limit	35,000	50,000	50,000

Note (1) Information extracted from the Annual Treasury Management Strategy 2020/21.

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.