



Treasury Management Strategy 2017/18

Committee Strategy and Programmes

Date of meeting 17 March 2017

Date of report 9 March 2017

Report by Assistant Chief Executive (Business Support)

1. Object of report

To update members on treasury management processes and seek approval for the proposed treasury management strategy for the financial year 2017/18.

2. Background

SPT has adopted the CIPFA Code of Practice on Treasury Management and fully complies with its requirements.

The primary requirements of the Code 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 local authority’s cash flows; its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of the 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 seeks approval for the proposed treasury management strategy for the year ahead.

This report covers:

- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- the capital plans (including prudential indicators); and
- an investment strategy (the parameters on how investments are to be managed).

3. Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital issues

- the capital plans and the prudential indicators.

Treasury management issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of SPT;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Scottish Government Investment Regulations.

The Committee will be aware that SPT normally prepares an aligned three year rolling capital programme and budget which seeks to balance the transport project delivery aspirations and the available funding. SPT has again prepared a programme covering the period 2017/18 to 2019/20 but members are advised that in doing so no funding information for years two or three is known at this stage. Therefore the capital programme and capital funding for 2018/19 and 2019/20 is based on estimates and is indicative only, noting that this will be refined and resubmitted at a later stage when funding information is available.

4. The Capital Prudential Indicators 2016/17 to 2019/20

SPT's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

4.1 Capital expenditure

This prudential indicator is a summary of SPT's capital expenditure plans.

Table 1	2015/16 Actual £000	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
Capital Expenditure	54,595	61,435	85,355	77,198	47,574
Capital grants and contributions	24,512	36,226	55,160	73,977	75,743
Transfers (to) / from Capital Grants Unapplied Account	6,061	5,720	13,079	1,991	-29,469
Revenue contribution to the capital programme	5,596	1,800	0	0	0
Subway fund utilisation	16,969	17,689	17,116	1,230	1,300
General Fund	1,357	0	0	0	0
Capital Receipts Reserve	100	0	0	0	0
Capital Funding	54,595	61,435	85,355	77,198	47,574

4.2 SPT's borrowing need (the Capital Financing Requirement)

The Capital Financing Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of SPT's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

Table 2	2015/16 Actual £000	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
Capital Financing Requirement	0	0	0	0	0

4.3 The Use of SPT's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (e.g. asset sales). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

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Table 3 Year End Resources	2015/16 Actual £000	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
General Fund Balance	11,169	11,169	11,169	11,169	11,169
Capital Receipts Reserve	22,872	22,872	22,872	22,872	22,872
Capital Grants Unapplied Account	28,161	22,441	9,362	1,792	31,261
Subway fund	24,492	16,840	10,730	19,811	25,991
Total core funds	86,694	73,322	54,133	55,644	91,293
Investments	96,568	83,196	64,007	65,518	101,167*

* Note - the increase in Investments in 2019/20 relates to the Scottish Government Specific Grant for Subway Modernisation being received in advance of the spend profile.

4.4 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the SPT's overall finances.

Actual and estimates of the ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Table 4	2015/16 Actual	2016/17 Forecast	2017/18 Forecast	2018/19 Estimate	2019/20 Estimate
SPT	-2%	-2%	-1%	-1%	-1%

This indicator is dependent on the mix of borrowing / utilisation of the Subway Fund applied in future years.

5. Treasury Management Consultants

SPT uses Capita Asset Services as its external treasury management advisors. SPT recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers, whilst recognising the value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

6. Treasury Management Strategy

The capital expenditure plans set out in Section 4 provide details of the service activity of SPT. The treasury management function ensures that SPT's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

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6.1 Current Portfolio Position

SPT's treasury portfolio position, with forward projections is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 5	2015/16 Actual £000	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
External Debt					
Debt at 1 April	0	0	0	0	0
Expected change in Debt	0	0	0	0	0
Actual debt at 31 March	0	0	0	0	0
The Capital Financing Requirement	0	0	0	0	0
Under / (over) borrowing	0	0	0	0	0
Investments	101,168	96,568	83,196	64,007	65,518
Investment change	-4,600	-13,372	-19,189	1,511	35,649
Total Investments	96,568	83,196	64,007	65,518	101,167
Net Debt	-96,568	-83,196	-64,007	-65,518	-101,167

Within the prudential indicators there are a number of key indicators to ensure that SPT operates its activities within well-defined limits. One of these is that SPT needs to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

6.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary: This 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 would also include an allowance for risk.

Table 6 Operational Boundary	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
Debt	20,000	30,000	60,000	60,000

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The Authorised Limit for external borrowing: A further key prudential indicator represents a control on the maximum level of debt. This represents a 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.

Table 7 Authorised Limit	2016/17 Forecast £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000
Debt	22,000	33,000	66,000	66,000

6.3 Prospects for Interest Rates

SPT has appointed Capita Asset Services as its treasury advisor and the following table gives their view on the prospects for interest rates.

Table 8	Bank Rate	PWLB Borrowing Rates		
	%	5 year	10 year	25 year
March 2017	0.25%	1.60%	2.30%	2.90%
June 2017	0.25%	1.60%	2.30%	2.90%
September 2017	0.25%	1.60%	2.30%	2.90%
December 2017	0.25%	1.60%	2.30%	3.00%
March 2018	0.25%	1.70%	2.30%	3.00%
June 2018	0.25%	1.70%	2.40%	3.00%
September 2018	0.25%	1.70%	2.40%	3.10%
December 2018	0.25%	1.80%	2.40%	3.10%
March 2019	0.25%	1.80%	2.50%	3.20%
June 2019	0.50%	1.90%	2.50%	3.20%
September 2019	0.50%	1.90%	2.60%	3.30%
December 2019	0.75%	2.00%	2.60%	3.30%
March 2020	0.75%	2.00%	2.70%	3.40%

6.4 Economic Outlook

UK economic growth (GDP) rates in 2014 (2.9%), 2015 (1.8%) and 2016 (1.8%) were some of the strongest rates amongst the G7 countries.

Following the EU referendum vote for “Brexit” in June 2016 there was a sharp fall in confidence indicators and business surveys, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending slowdown in the economy. The Monetary Policy Committee (MPC) responded to this in August 2016 with a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing and a tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The latest MPC forecast (published 02/02/17) is that economic growth will remain relatively strong in 2017 at 2.0%, and thereafter slowing to 1.6% in 2018 and 1.7% in 2019. Continued

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moderation in pay growth coupled with higher import prices is likely to slow consumer spending.

The MPC target of 2% for CPI is likely to be exceeded over the next few years as a consequence of the fall in sterling boosting consumer prices. The latest MPC forecast is that CPI inflation will continue to rise to 2.8% in Q1 2018 before gradually falling back to 2.4% in 2020.

Bank rate started the year at 0.5% but fell to 0.25% in August and remains unchanged. Bank Rate is expected to start increasing gradually from Q2 2019.

The longer term trend is still for Public Works Loan Board (PWLB) borrowing rates to rise.

The process to leave the EU is expected to start in March 2017 with notification under Article 50 triggering a two-year negotiation period on the agreed terms of the exit and a new bi-lateral trade agreement. However, the UK may also leave the EU without any such agreements being reached. During the negotiation period the UK will continue as an EU member state with access to the single market and tariff free trade with the other EU member states.

6.5 Borrowing Strategy

SPT is currently debt free, but may need to borrow in future to fund the Subway Modernisation programme for cash flow purposes as the grant received and planned profile does not reflect the expected timing of payments due. The funding schedule submitted to government in support of the programme is based on borrowing occurring in one phase.

There are three debt related treasury activity limits. The purpose of these indicators are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce SPT's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Table 9 Interest Rate Exposures	Percentage of outstanding principal sums
Borrowing	
Limits on fixed interest rate exposures	60 to 100
Limits on variable interest rate exposures	0 to 40
Investing	
Limits on fixed interest rate exposures	0 to 50
Limits on variable interest rate exposures	50 to 100

Table 10 Maturity Structure of Borrowing		
The amount of projected borrowing maturing in each period as a percentage of total projected borrowing that is fixed rate.		
	Lower Limit %	Upper Limit %
under 12 months	0	50
12 months and within 24 months	0	100
24 months and within 5 years	0	100
5 years and within 10 years	0	100
10 years and within 25 years	10	100
25 years and within 50 years	10	100

6.6 Policy on Borrowing in Advance of Need

The timing of any borrowings will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that SPT can ensure the security of such funds. SPT will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

6.7 Annual Investment Strategy

6.7.1. Investment Policy

SPT's investment policy has regard to the Local Government Investment (Scotland) Regulations (and accompanying finance circular) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). SPT's investment priorities will be security first, liquidity second and then return.

In accordance with the above guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, SPT has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. Potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Further, SPT officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end SPT will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps (CDS)" and overlay that information on top of the credit ratings.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

6.7.2. Creditworthiness Policy

SPT applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by SPT to determine the suggested duration for investments.

SPT will therefore use counterparties within the following durational bands.

Table 11 Key to bands used on Counterparty List	
Colour code	Duration (up to)
Yellow	60 Months
Purple	24 Months
Blue	12 Months (only applies to U.K. Nationalised and Part Nationalised Banks)
Orange	12 Months
Red	6 Months
Green	100 Days
No Colour	0 Months (i.e. not to be used)

The Capita Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

A full list of SPT's potential counterparties can be found at Appendix 1.

6.7.3. Permitted Investments

The Investment Regulations (Code on the Investment of Money by Local Authorities) requires the Committee approval of all the types of investments to be used and set appropriate limits for the amount that can be held in each investment type.

Details of all permitted investments can be found at Appendix 2.

6.7.4. Counterparty Limits

SPT's counterparty limits are set 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.

6.7.5. Investment Treasury Indicator and Limit

The Investment Treasury Indicator and Limit is the total principal funds invested for greater than 364 days. These limits are set with regard to SPT's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Table 12	2016/17 £000	2017/18 £000	2018/19 £000	2019/20 £000
Principal sums invested > 364 days	35,000	25,000	25,000	25,000

7. Committee action

The committee is recommended to:

- approve the Treasury Management Strategy for 2017/18;
- approve SPT's prudential indicators as detailed in the report;
- approve the Counterparty List detailed in Appendix 1;
- approve the Permitted Investment Types detailed in Appendix 2.

8. Consequences

Policy consequences	<i>None</i>
Legal consequences	<i>All legislation and regulations are adhered to.</i>
Financial consequences	<i>The contents of this report have been incorporated into SPT's 2017/18 budgets.</i>
Personnel consequences	<i>None</i>
Equalities consequences	<i>None</i>
Risk consequences	<i>As detailed in report</i>

Name Valerie Davidson

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

Name Gordon MacLennan

Title **Chief Executive**

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

SPT's Counterparty List

Counterparty Institution	Country / Classification	Band
Abbey National Treasury Services plc	U.K	Red
Bank of Scotland Plc	U.K	Red
Barclays Bank plc	U.K	Red
Close Brothers Ltd	U.K	Red
Goldman Sachs International Bank	U.K	Red
HSBC Bank plc	U.K	Orange
Lloyds Bank Plc	U.K	Red
Santander UK plc	U.K	Red
Standard Chartered Bank	U.K	Red
Sumitomo Mitsui Banking Corporation Europe Ltd	U.K	Red
UBS Ltd	U.K	Red
Coventry BS	U.K. Building Societies	Red
Leeds BS	U.K. Building Societies	Red
Nationwide BS	U.K. Building Societies	Red
Skipton BS	U.K. Building Societies	Green
Yorkshire BS	U.K. Building Societies	Green
Collateralised LA Deposit	AAA rated and Government backed securities	Yellow
Debt Management Office	AAA rated and Government backed securities	Yellow
Supranationals	AAA rated and Government backed securities	Yellow
UK Gilts	AAA rated and Government backed securities	Yellow
National Westminster Bank Plc	Nationalised and Part Nationalised Banks	Blue
Royal Bank of Scotland Group plc	Nationalised and Part Nationalised Banks	Blue
The Royal Bank of Scotland Plc	Nationalised and Part Nationalised Banks	Blue
National Bank of Abu Dhabi	Abu Dhabi (U.A.E)	Orange
Australia and New Zealand Banking Group Ltd	Australia	Orange
Commonwealth Bank of Australia	Australia	Orange
Macquarie Bank Limited	Australia	Red
National Australia Bank Ltd	Australia	Orange
Westpac Banking Corporation	Australia	Orange
BNP Paribas Fortis	Belgium	Red
KBC Bank NV	Belgium	Red
Bank of Montreal	Canada	Orange

Counterparty Institution	Country / Classification	Band
Bank of Nova Scotia	Canada	Orange
Canadian Imperial Bank of Commerce	Canada	Orange
National Bank of Canada	Canada	Red
Royal Bank of Canada	Canada	Orange
Toronto Dominion Bank	Canada	Orange
Danske Bank	Denmark	Red
Nordea Bank Finland plc	Finland	Orange
OP Corporate Bank plc	Finland	Orange
BNP Paribas	France	Red
Credit Agricole Corporate and Investment Bank	France	Red
Credit Agricole SA	France	Red
Credit Industriel et Commercial	France	Red
Societe Generale	France	Red
BayernLB	Germany	Red
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	Germany	Orange
Landesbank Baden Wuerttemberg	Germany	Red
Landesbank Berlin AG	Germany	Orange
Landesbank Hessen-Thueringen Girozentrale (Helaba)	Germany	Orange
Landwirtschaftliche Rentenbank	Germany	Purple
Norddeutsche Landesbank Girozentrale	Germany	Green
NRW.BANK	Germany	Purple
ABN AMRO Bank N.V.	Netherlands	Red
Bank Nederlandse Gemeenten	Netherlands	Purple
Cooperatieve Rabobank U.A.	Netherlands	Orange
ING Bank NV	Netherlands	Red
Nederlandse Waterschapsbank N.V	Netherlands	Purple
Qatar National Bank	Qatar	Orange
DBS Bank Ltd	Singapore	Orange
Oversea Chinese Banking Corporation Ltd	Singapore	Orange
United Overseas Bank Ltd	Singapore	Orange
Nordea Bank AB	Sweden	Orange
Skandinaviska Enskilda Banken AB	Sweden	Orange
Svenska Handelsbanken AB	Sweden	Orange
Swedbank AB	Sweden	Orange
Credit Suisse AG	Switzerland	Green
UBS AG	Switzerland	Orange
Bank of America, N.A.	U.S.A	Orange

Counterparty Institution	Country / Classification	Band
Bank of New York Mellon, The	U.S.A	Purple
Citibank, N.A.	U.S.A	Red
JPMorgan Chase Bank NA	U.S.A	Orange
Wells Fargo Bank NA	U.S.A	Orange

Key to bands used on Counterparty List:	
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Red	6 Months
Green	100 Days
No Colour	0 Months (i.e. not to be used)

Permitted Investment Types

1. Cash type instruments	
a)	Deposits with the Debt Management Account Facility (UK Government)
b)	Deposits with other local authorities or public bodies
c)	Money Market Funds (MMFs)
d)	Enhanced Money Market Funds (EMMFs)
e)	Call account deposit accounts with financial institutions (banks and building societies)
f)	Term deposits with financial institutions (banks and building societies)
h)	Government Gilts and Treasury Bills
i)	Certificates of deposits with financial institutions
j)	Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.)

2. Other investments	
a)	Investment properties
b)	Loans to third parties, including soft loans
c)	Loans to a local authority company
d)	Shareholdings in a local authority company
e)	Non-local authority shareholdings

Treasury Management Policy Statement

Strathclyde Partnership for Transport has defined the policies and objectives of its treasury management activities as follows:

- (A) SPT defines its treasury management activities as:

“The management of the organisation’s investments and cash flows, its banking, money markets and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”
- (B) SPT regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.
- (C) SPT acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.