Agenda Item 7

Committee report

Mid-Year Treasury Management Report 2021/22

Committee Strategy and Programmes

Date of meeting 26 November 2021 **Date of report** 16 November 2021

Report by Director of Finance

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.

In September 2021, CIPFA issued consultations on both the Code of Practice and the Prudential Code. The proposed revisions cover a number of areas with a focus on commercial investment provisions. There are also proposals regarding the management of environmental, social and governance risk considerations. The consultation closed on 16 November 2021 and any resultant changes to the codes will be adopted by SPT.

3. The Economy and Interest Rates

3.1 Economic performance to date and outlook

The UK economy is recovering from the impact of the Covid-19 pandemic. There has been a rise in spending by households and businesses. Inflationary pressures have increased but this is expected to be temporary. Unemployment has fallen, although the number of people out of work is still higher than it was before the pandemic.

UK GDP in volume terms is estimated to have risen by 5.5% in 2021 Quarter 2 (April to June). The expectation is that UK GDP will get back to its 2019 Q4 level in 2022 Quarter 1 (January to March).

CPI inflation has increased from 1.5% in April 2021 to 3.1% in September 2021 and is now expected to peak at around 5% in April 2022, owing largely to developments in energy and goods prices. The upward pressure on CPI inflation is expected to dissipate over time, as supply disruption eases, global demand rebalances, and energy prices stop rising. As a result, CPI inflation is projected to fall back materially from the second half of 2022 and to be around 2% in two years' time.

The unemployment rate was 4.5% in the three months to August 2021. Employment has fallen since the Covid-19 outbreak, although this has been significantly mitigated by the extensive take-up of support from temporary government schemes. There is uncertainty around how the economy will adjust to the closure of the furlough scheme at the end of September. The evidence from surveys and other indicators is that there are few signs of any increase in redundancies, job vacancy levels have increased further and employers are encountering recruitment difficulties. Underlying pay growth is estimated to have picked up, to above its pre-pandemic rate. The unemployment rate is expected to fall back in early 2022.

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 2021 the MPC voted by a majority to maintain Bank Rate at 0.10% and to continue its' existing programme of Quantitative Easing at £895bn.

The MPC expects that Bank Rate will need to rise modestly to meet the 2% inflation target sustainably in the medium term. Nevertheless, near-term uncertainties remain, especially around the outlook for the labour market, and the extent to which domestic cost and price pressures persist into the medium term. The MPC will continue to monitor the situation closely and stands ready to adjust monetary policy accordingly to meet its remit.

3.2 Link Asset Services' forecast for Bank Rate interest

SPT has appointed Link Group as its treasury management advisors and the following table gives their current view on the prospects for interest rates.

Table 1

Now	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
0.10	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00

The investment environment is now one characterised by very low rates of return. However, SPT's investment priorities continue to be security first, liquidity second and then return.

4. Treasury Management Strategy Update

The Treasury Management Strategy 2021/22, including the Annual Investment Strategy, was approved by the Partnership on 12 March 2021.

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 2021/22 as approved by the Partnership on 17 September 2021.

Table 2	**Subway Modernisation £000**	**General Capital £000**	**Total £000**
Capital Programme approved by the Partnership on 12 March 2021	17,103	22,250	39,353
Amendments approved by the Strategy & Programmes Committee	0	(10)	(10)
Revised Capital Programme as at 17 September 2021	**17,103**	**22,240**	**39,343**

5.2 Changes to the financing of the capital programme

Table 3 below provides a summary of the available capital funding for 2021/22 as approved by the Partnership on 12 March 2021.

Table 3	Subway Modernisation £000	General Capital £000	Total £000
Scottish Government general capital grant	0	15,327	15,327
Scottish Government specific capital grant*	35,000	0	35,000
Other grants and contributions	0	50	50
Transfer from Subway Infrastructure Fund (General Fund - Earmarked Reserve)	0	5,300	5,300
Available capital funding 2021/22	**35,000**	**20,677**	**55,677**

* Note - ring-fenced grant funding.

Subsequently, the profile of the Scottish Government specific grant funding for Subway Modernisation has been revised following discussions with Transport Scotland. SPT will receive no grant funding in the current financial year and will utilise unspent Scottish Government specific grant from previous years to fund the project. The grant allocation for 2021/22 has been re-profiled into future years.

Table 4 below provides a summary of the revised capital funding available for 2021/22 as approved by the Partnership on 17 September 2021.

Table 4	Subway Modernisation £000	General Capital £000	Total £000
Scottish Government general capital grant	0	15,327	15,327
Scottish Government specific capital grants	0	0	0
Other grants and contributions	0	50	50
Transfer from Subway Infrastructure Fund (General Fund - Earmarked Reserve)	0	5,300	5,300
Available capital funding 2021/22	**0**	**20,677**	**20,677**

5.3 Revised capital programme position

Table 5 below provides a summary of the capital position as approved by the Partnership on 17 September 2021.

Table 5	Subway Modernisation £000	General Capital £000	Total £000
Revised Capital Programme as at 17 September 2021	17,103	22,240	39,343
Available capital funding 2021/22	0	20,677	20,677
Transfer from Capital Grants Unapplied Account	17,103	0	17,103
Projected variance	**0**	**1,563**	**1,563**

It is anticipated that the measures put in place in response to the Covid-19 pandemic together with global supply chain issues and inflationary pressures will continue to affect the delivery of projects in 2021/22 and that further budget amendments will be necessary.

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 Operational Boundary

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	**2021/22 Original Forecast as at 12/03/2021 £000**	**2021/22 Revised Forecast as at 17/09/2021 £000**
Capital Programme	39,353	39,343
Available Funding	55,677	20,677
Transfer from / (to) Capital Grants Unapplied Account	(17,897)	17,103
Transfer from Capital Fund	1,573	1,563
Capital Financing Requirement	**0**	**0**

5.4.2 Portfolio position

SPT's treasury portfolio position is summarised in Tables 7 and 8 below.

Table 7 **Treasury Investments**	**2021/22 Original Forecast £000**	**2021/22 Revised Forecast £000**
Banks and building societies (rated)		
Managed in-house	176,127	164,000
Managed externally	0	0
Total Investments	**176,127**	**164,000**

The original forecast for investments was produced before the actual year-end position was known for 2020/21. The opening position for 2021/22 was actually £12.774m more than forecast mainly due to an underspend on the capital programme.

Scottish Government specific capital grant funding of £35m for Subway Modernisation will not now be received in 2021/22, having been re-profiled into future years following discussions with Transport Scotland.

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 including the significant impact of the Covid-19 pandemic on SPT's income and potential spend-risk on the capital programme.

Table 8 shows the external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 8 **External Debt**	**2021/22 Original Forecast £000**	**2021/22 Revised Forecast £000**
Gross debt at 1 April	0	0
Expected change in gross debt	0	0
Gross debt at 31 March	**0**	**0**
The Capital Financing Requirement	**0**	**0**
Under / (over) borrowing	0	0

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 gross debt 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 2021/22 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 or speculative purposes.

5.4.3 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 9 below, the Operational Boundary and Authorised Limit on External Debt have not changed from the original estimates.

Table 9	**2021/22 Original Forecast £000**	**2021/22 Revised Forecast £000**
Operational Boundary	50,000	50,000
Authorised Limit for External Debt	55,000	55,000

6. Investment Strategy

The Treasury Management Strategy 2021/22 was approved by the Partnership on 12 March 2021.

In terms of investment policy, the 2021/22 Strategy states that “SPT’s investment priorities will be security first, liquidity second and then return.” During the first six months of 2021/22 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 2021/22 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 2021/22 this policy was followed in full.

In terms of credit rating criteria, SPT applies the service provided by our treasury management advisors, Link Group, for choosing investment counterparties. This 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 2021/22 this credit rating policy was followed in full and there were no liquidity difficulties.

In terms of counterparty limits, the 2021/22 Strategy set these 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.

During the first six months of 2021/22 this policy was followed in full.

The approved Counterparty List for 2021/22 is shown at Appendix 1, with updated credit ratings. During the first six months of 2021/22, SPT has only held investment balances with approved UK institutions.

7. Investment Outturn

The result of the investment strategy undertaken by SPT to Period 7 (ending 9 October 2021) is shown in the Table 10 below.

Table 10	Average Investment £000	Average Rate of Return %	Benchmark Return* %	Liquidity
Account 1	2,889	0.00	-0.08	Instant Access
Account 2	22,143	0.15	-0.08	95 Day Notice
Account 3	872	0.01	-0.08	Instant Access
Account 4	23,920	0.01	-0.08	Instant Access
Account 5	15,000	0.03	-0.08	Fixed Term
Account 6	5,006	0.09	-0.08	Instant Access
Account 7	16	0.00	-0.08	Instant Access
Account 8	19	0.10	-0.08	31 Day Notice
Account 9	10,468	0.15	-0.08	Instant Access
Account 10	30,728	0.35	-0.08	35 Day Notice
Account 11	10,010	0.35	-0.08	95 Day Notice
Account 12	3,006	0.04	-0.08	Instant Access
Account 13	5,012	0.30	-0.08	31 Day Notice
Account 14	45,961	0.40	-0.08	95 Day Notice

*The benchmark return is the 7-day LIBID uncompounded.

SPT earned interest of £0.224m during the first six months of 2021/22, against budgeted income of £0.215m.

The overall average rate of return obtained equates to 0.23% per annum, which exceeds the benchmark by 0.31% per annum and the prevailing Bank Rate by 0.13%. The benchmark return shown in Table 10 was actually negative due to Bank 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 10 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 10 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 2021/22 and remains debt free.

9. Conclusion

During the first six months of 2021/22 SPT has operated within the Treasury Limits and Prudential Indicators set out in the Treasury Management Strategy 2021/22. All treasury management operations have also been conducted in full compliance with SPT's Treasury Management Practices.

10. Committee action

The Committee is requested 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	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.

Appendix 1

SPT's Counterparty List 2021/22

Investment balances have been held with the following counterparties so-far during financial year 2021/22:

Counterparty Institution	Country / Classification	Band
Bank of Scotland PLC	UK / Bank	Red
Barclays Bank PLC	UK / Bank	Red
Goldman Sachs International Bank	UK / Bank	Red
HSBC UK Bank Plc	UK / Bank	Orange
Santander UK PLC	UK / Bank	Red
The Royal Bank of Scotland Plc	UK / Part Nationalised Bank	Blue
Nationwide Building Society	UK / Building Society	Red

Investment balances could also potentially be held with the following counterparties during financial year 2021/22:

Counterparty Institution	Country / Classification	Band
Abbey National Treasury Services PLC	UK / Bank	No Colour
Al Rayan Bank Plc	UK / Bank	Red
Barclays Bank UK PLC	UK / Bank	Red
Close Brothers Ltd	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	Red
National Bank of Kuwait (International) PLC	UK / Bank	Orange
NatWest Markets Plc	UK / Bank	Red
SMBC Bank International Plc	UK / Bank	Red
Standard Chartered Bank	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	Red
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)