APPENDIX A

TREASURY MANAGEMENT ANNUAL REPORT 2019/20

INTRODUCTION

1. The CIPFA Code of Practice for Treasury Management in Local Authorities has been adopted by the Authority. The Code requires that Treasury Management activities are subject to regular reports to Members. This report represents the final report on Treasury Management for 2019/20.

2. The strategy for the year was identified in the Treasury Management Strategy Statement 2019/20. The strategy covers the following areas:

(a) prospects for interest rates;
(b) capital borrowing and debt rescheduling;
(c) annual investment strategy;
(d) external debt prudential indicators;
(e) treasury management prudential indicators.
(f) performance indicators;
(g) treasury management advisors

PROSPECTS FOR INTEREST RATES

3. Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that the Bank Rate would remain at 0.75%. A recurring theme throughout 2019/20 in the UK was the uncertainty regarding the withdrawal process from the European Union, acting as a dampener on growth and inflation expectations. The initial departure deadline of 29th March 2019 was initially extended to 12th April, then to 31st October and finally 31st January 2020. The General election in December 2019 provided a working majority to the conservative party and in January 2020 the Government was able to pass the withdrawal agreement legislation, taking the UK into a transition period that is due to run until 31st December 2020. Any hopes that the move to the transition period might lead to an increase in growth, were quickly dashed as the full effects of the coronavirus pandemic began to emerge. Following the initial outbreak and subsequent lockdown in China, the virus has spread globally with hotspots in Europe and the United States of America. In the UK a lockdown was implemented in late March with the closure of schools and all non-essential retail outlets.

4. In response to the emerging crisis central banks globally have cut interest rates and sought to provide liquidity through the purchase of financial assets. In the UK the Bank of England cut rates to 0.25% from 0.75% and subsequently cut again to a record low level of 0.1%. The Government has introduced a number of measures to help businesses survive the current crisis, these measures include loan guarantees for bank lending, payment of business grants and the expansion of retail relief reducing the business rates liability for many businesses.

5. Given the uncertainty throughout 2019/20 a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

6. PWLB rates and gilt yields have continued to experience levels of volatility linked to geo-political, sovereign debt crisis and emerging market developments. Following a decline in gilt yields over the summer months, on the 9th October 2019 HM Treasury suddenly announced that with immediate affect the PWLB margin above UK gilts would be increased from 80 bps to 180 bps. This announcement increased the borrowing costs on newly arranged loans from PWLB by 1%. At the same time the Treasury increased the lending limit of the PWLB from £85B to £95B. There has been speculation that the increase in rate was designed to halt the pace at which the new limit would be reached following record levels of new loan issuance by the PWLB in the months of August and September.

7. The overall structure of interest rates has for some time meant that short term rates have remained lower than long term rates. In this scenario, the strategy has continued to be to reduce investments and borrow for short periods and possibly at variable rates when required. However, this needs careful review to avoid incurring higher borrowing costs in the future when the authority may not be able to avoid new borrowing to finance capital expenditure and/or refinance maturing debt.

CAPITAL BORROWINGS AND DEBT RESCHEDULING

8. The borrowing requirement comprises the expected movements in the Capital Financing Requirement and reserves plus any maturing debt which will need to be re-financed. The Authority did not envisage that any new long term borrowing would be required in 2019/20 and no new borrowing was arranged. Market conditions continued to be unfavourable for any debt rescheduling.

ANNUAL INVESTMENT STRATEGY

9. The investment strategy for 2019/20 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with central government regulations and CIPFA Code of Practice. Investments are made in sterling with an institution on the counterparty list and for a maximum of one-year duration.

10. Extreme caution was taken in placing investments to ensure security of funds rather than rate of return. The use of deposit accounts with high rated or nationalised banks and AAA rated money market funds has enabled reasonable returns in a low interest rate environment. The credit ratings and individual limits for each institution to be used by the Authority in 2019/20 are outlined below:

UK Government (including gilts and the DMADF)	Unlimited
UK Local Authorities (each)	Unlimited
Part Nationalised UK banks	£4m
Money Market Funds (AAA rated)	£3m
Enhanced Money Market (Cash) Funds (AAA rated)	£3m
UK Banks and Building Societies (A- or higher rated)	£2m
Foreign banks registered in the UK (A or higher rated)	£2m

The average rate of return achieved on average principal available in 2019/20 was 0.88%. This compares with an average seven day deposit (7 day libid) rate of 0.54%.

11. The Investment Strategy specified that investments are only made with banks with a high credit rating. UK banks must have at least an “A” long term rating for inclusion on

the Authority's counterparty list. The money markets are continually monitored for information regarding the creditworthiness of financial institutions and notifications are received of any changes to credit ratings made by any of the rating agencies. An institution is immediately suspended from the Authority's list of institutions should any doubt arise about its financial standing regardless of whether its credit rating is downgraded.

EXTERNAL DEBT PRUDENTIAL INDICATORS

12. The external debt indicators of prudence for 2019/20 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£70 million
Operational boundary for external debt:	£59 million

Against these limits, the maximum amount of debt reached at any time in the financial year 2019/20 was £37.6 million.

13. **Gross borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Authority should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2018/19) plus the estimates of any additional capital financing requirement for the current (2019/20) and next two financial years. This essentially means that the Authority is not borrowing to support revenue expenditure. This indicator allows the Authority some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Authority's gross borrowing position against the CFR. Although the level of debt exceeds the borrowing CFR this can be explained by the current policy of using any one-off savings to make additional MRP payments that result in a £ for £ reduction in the CFR figure but actual borrowing remains unchanged (in 2019/2020 the additional MRP payment was £2.5m). All long term borrowing has been incurred to fund capital investment.

	31 March 2019	**31 March 2020**	**31 March 2021**
	Actual	**Actual**	**Estimate**
	£'m	**£'m**	**£'m**
Capital Financing Requirement	58.4	50.7	63.0
Less: PFI	(18.1)	(17.8)	(17.3)
Less:MRD	(0.3)	(0.2)	(0.2)
Borrowing CFR	**40.0**	**32.7**	**45.5**
Existing Debt Portfolio	37.6	37.3	36.9
Over(-)/Under borrowing	**2.3**	**(4.6)**	**8.6**
Borrowing as a % of CFR	**94.0%**	**114.1%**	**81.1%**

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

14. The treasury management indicators of prudence for 2019/20 required by the Prudential Code were set in the strategy as follows:

a) Interest Rate Exposures

Upper limit on fixed interest rate exposures: 100%
Upper limit on variable interest rate exposures: 50%

The maximum that was reached in the financial year 2019/20 was as follows:

Upper limit on fixed interest rate exposures: 100%
Upper limit on variable interest rate exposures: 0%

b) Maturity Structure of Borrowing

Upper and lower limits for the maturity structure of borrowing were set and the maximum and minimum that was reached for each limit at any time in the financial year 2019/20 was as follows:

Maturity Period	Upper Limit	Lower Limit	Maximum Actual	Minimum Actual
Under 12 months	50%	0%	1%	1%
12 months and within 24 months	50%	0%	1%	0%
24 months and within 5 years	50%	0%	9%	8%
5 years and within 10 years	50%	0%	0%	0%
10 years and above	90%	0%	90%	90%

c) **Total principal sums invested for periods longer than 365 days**

The limit for investments of longer than 364 days was set at £2 million for 2019/20. One investment of £2m was placed for 366 days during 2019/20.

PERFORMANCE INDICATORS

15. The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

16. The indicators for the treasury function are:

Borrowing - Average rate of long term borrowing for the year compared to average available. No new long term borrowing was arranged in 2019/20.

Investments – Internal returns compared to the 7 day LIBID rate. The return in the financial year 2019/20 was 0.34% above the benchmark.

TREASURY MANAGEMENT ADVISORS

17. The treasury management service is provided to the Authority by Liverpool City Council. The terms of the service are set out in an agreed Service Level Agreement. The Council employs treasury management advisers appointed under a competitive procurement exercise who provide a range of services which include: -

    - Technical support on treasury matters, capital finance issues.
    - Economic and interest rate analysis.
    - Debt services which includes advice on the timing of borrowing.
    - Debt rescheduling advice surrounding the existing portfolio.
    - Generic investment advice on interest rates, timing and investment instruments.
    - Credit ratings/market information service comprising the three main credit rating agencies.

18. Whilst Liverpool City Council and its advisers provide the treasury function, ultimate responsibility for any decision on treasury matters remains with the Authority.

CONCLUSION

19. Treasury Management activity in 2019/20 has been carried out in compliance with the relevant Codes and Statutes and within the borrowing and treasury management limits set by the Authority under the prudential code.