APPENDIX A

TREASURY MANAGEMENT ANNUAL REPORT 2020/21

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 2020/21.

2. The strategy for the year was identified in the Treasury Management Strategy Statement 2020/21. 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 2020/21 as the coronavirus pandemic continued to dominate the year. The Bank of England (BoE) held Bank Rate at 0.10% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn. The Bank Rate is unlikely to change despite developing market expectation.

4. Given the uncertainty throughout 2020/21 a cautious approach has been maintained, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5. In November 2020 the Public Works Loan Board (PWLB) published its response to the consultation on 'Future Lending Terms'. From 26th November the margin on PWLB loans above gilt yields was reduced from 1.8% to 0.8% providing that the borrowing authority can confirm that it is not planning to purchase 'investment assets primarily for yield' in the current or next two financial years. Authorities that are purchasing or intending to purchase investment assets primarily for yield will not be able to access the PWLB except to refinance existing loans or externalise internal borrowing. As part of the borrowing process authorities will now be required to submit more detailed capital expenditure plans with

confirmation of the purpose of capital expenditure from the Section 151 Officer. The PWLB can now also restrict local authorities from borrowing in unusual or large amounts.

6. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management. Misuse of PWLB borrowing could result in the PWLB requesting that Authority unwinds problematic transactions, suspending access to the PWLB and repayment of loans with penalties.

7. Competitive market alternatives may be available for authorities with or without access to the PWLB. However, the financial strength of the individual authority and borrowing purpose will be scrutinised by commercial lenders.

8. The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able to take advantage of the reduction in the PWLB borrowing rate.

9. 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

10. 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 2020/21 and no new long-term borrowing was arranged. Market conditions continued to be unfavourable for any debt rescheduling.

ANNUAL INVESTMENT STRATEGY

11. The investment strategy for 2020/21 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.

12. 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 2020/21 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 2020/21 was 0.42%. This compares with an average seven-day deposit (7-day libid) rate of minus 0.07%.

13. 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

14. The external debt indicators of prudence for 2020/21 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£64 million
Operational boundary for external debt:	£58 million

Against these limits, the maximum amount of debt reached at any time in the financial year 2020/21 was £37.3 million.

15. **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 (2019/20) plus the estimates of any additional capital financing requirement for the current (2020/21) 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. The Authority has complied with this prudential indicator.

	31 March 2020	**31 March 2021**	**31 March 2022**
	Actual	**Actual**	**Estimate**
	£'m	**£'m**	**£'m**
Capital Financing Requirement	50.7	52.2	61.8

Less: PFI	(17.8)	(17.3)	(16.9)
Less:MRD	(0.2)	(0.2)	(0.2)
Borrowing CFR	**32.7**	**34.7**	**44.7**
Existing Debt Portfolio	37.3	37.1	33.9
Over(-)/Under borrowing	**(4.6)**	**(2.4)**	**10.8**
Borrowing as a % of CFR	**114.1%**	**106.9%**	**75.8%**

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

16. The treasury management indicators of prudence for 2020/21 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 2020/21 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 2020/21 was as follows:

Maturity Period	**Upper Limit**	**Lower Limit**	**Maximum Actual**	**Minimum Actual**
Under 12 months	50%	0%	9%	1%
12 months and within 24 months	50%	0%	9%	1%
24 months and within 5 years	50%	0%	1%	0%
5 years and within 10 years	50%	0%	0%	0%
10 years and above	95%	0%	91%	90%

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

The limit for investments of longer than 365 days was set at £2 million for 2020/21. No investments longer than 365 days have been placed during 2020/21.

PERFORMANCE INDICATORS

17. 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.

18. 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 2020/21.

Investments – Internal returns compared to the 7 day LIBID rate. The return in the financial year 2020/21 was 0.49% above the benchmark.

TREASURY MANAGEMENT ADVISORS

19. 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.

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

CIPFA CONSULTATIONS

21. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These follow the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. These are principles-based consultations and will be followed by more specific proposals later in the year.

22. In the Prudential Code the key area being addressed is the statement that "local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed". Other proposed changes include the sustainability of capital expenditure in accordance with an authority's corporate objectives, i.e. recognising climate, diversity and innovation, commercial investment being proportionate to budgets, expanding the capital strategy section on commercial activities, replacing the "gross debt and the CFR" with the liability benchmark as a graphical prudential indicator.

23. Proposed changes to the Treasury Management Code include requiring job specifications and "knowledge and skills" schedules for treasury management roles to be included in the Treasury Management Practices (TMP) document and formally reviewed, a specific treasury management committee for Markets in

Financial Instruments Directive regulations (MiFID II) professional clients and a new TMP 13 on Environmental, Social and Governance Risk Management.

IFRS 16

24. The implementation of the new IFRS 16 Leases accounting standard has been delayed for a further year until 2022/23.

CONCLUSION

25. Treasury Management activity in 2020/21 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.