Appendix A

TREASURY MANAGEMENT INTERIM REPORT 2021/22

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 reports to Members. This report represents the interim report for 2021/22.

2. For each financial year the Authority sets a balanced budget so that cash income raised during the year is sufficient to meet all of its cash expenditure commitments. One of the key functions of the Authority's treasury management activity is to ensure that these cash flows are effectively managed, so that cash is available when it is needed. Surplus cash is invested having regard to risk, liquidity and yield.

3. A further key function of the treasury management activity is to ensure that the Authority has sufficient funds to pay for its capital and other investment plans. These capital plans, which are set out in the Capital Programme, identify the borrowing needs of the Authority over a longer time horizon than the current year. In managing its longer term cash flow requirements for capital expenditure the Authority will take out loans or alternatively use its cash flow surpluses in lieu of external borrowing. This latter practice is referred to as "internal borrowing". In managing its loans, it may at times be advantageous for the Authority to repay or restructure its borrowings to optimise interest payments or achieve a balanced debt portfolio.

4. Having regard to these activities, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

   "The management of the Council's 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."

5. As treasury management decisions involve borrowing and investing substantial sums of money, the Authority is exposed to potentially large financial risks, including the loss of invested funds and the revenue effect of changing interest rates. The identification, control and monitoring of risk are therefore integral elements of treasury management activity.

6. The strategy for the year was identified in the Treasury Management Strategy Statement 2021/22 and was contained within the Budget and Financial Plan report CFO/010/21 approved by the Authority at its meeting on 25th February 2021. The strategy covered 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 advisers

7. The Treasury Management Interim Report considers actual treasury management performance up to September 2021.

EXECUTIVE SUMMARY of the key points on performance so far include:

- No new borrowing has been arranged in the year or is expected to be arranged.
- Borrowing of £3.00m is due to be repaid in the second half of 2021/22.
- Financial Investments at 30 September 2021 stood at £61.95m, with associated income of £0.044m.
- The Bank of England (BOE) base rate has remained at 0.10% throughout the period.
- Longer term Public Works Loan Board (PWLB) rates have fallen slightly during the first half of the year by 0.06% from 2.23% at the start of the year to 2.17 % at 30 September 2021.
- Treasury Management activity for 2021/22 has been carried out in compliance with the relevant codes and statutes and within the borrowing and treasury management limits approved by the Authority as part of the budget setting process.

PROSPECTS FOR INTEREST RATES

8. The economic recovery from coronavirus pandemic continued to dominate the first half of the financial year. The Bank of England (BoE) held Bank Rate at 0.10% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting.

9. Treasury advisors now expect the Bank Rate to rise to 0.25% in Q2 2022, and believe this is driven as much by the Bank of England's desire to move from emergency levels as by fears of inflationary pressure.

10. Investors have priced in multiple rises in Bank Rate to 1% by 2024. However, treasury advisors believe Bank Rate will rise by a lesser extent than expected by markets.

11. The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit.

12. While Q2 UK GDP (Gross Domestic Product) expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support.

13. Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC (Monetary Policy Committee) has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher.

14. The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain

sectors, driving inflation expectations. It is uncertain whether a broad-based increase in wages is possible given the pressures on businesses.

15. Government bond yields increased sharply following the September MPC minutes, in which the BOE communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.

16. The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

17. The PWLB certainty rate for borrowing is linked to Gilt yield plus a margin of 1.00%. Gilt yields declined following the start of this financial year before rising again towards the latter end of the half year. PWLB rates for longer term loans have fallen slightly by 0.06% during the first half of the financial year. The table below shows the spread of interest rates during the first six months of the year.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.98%	1.25%	1.59%	1.95%	1.69%
Date	26/05/21	05/8/21	05/8/21	17/8/21	10/8/21
High	1.18%	1.62%	2.01%	2.47%	2.26%
Date	30/9/21	28/9/21	30/9/21	19/5/21	13/5/21
30/9/21	1.18%	1.61%	2.01%	2.39%	2.17%
Average	1.04%	1.36%	1.80%	2.22%	2.01%

(*figures do not include 20bps certainty rate discount)*

18. Local authorities can borrow from the PWLB provided they can confirm they are not planning to purchase 'investment assets primarily for yield' in the current or next two financial years, with confirmation of the purpose of capital expenditure from the Section 151 Officer. 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.

19. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

20. 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. Further changes to the CIPFA Prudential Code expected in December 2021 are likely to prohibit borrowing for the primary purpose of commercial return even where the source of borrowing is not the PWLB.

21. The Authority is not planning to purchase any investment assets primarily for yield within the next three years and so is able fully access the PWLB.

22. **REVISED PWLB GUIDANCE;**

HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an 'investment asset primarily for yield'. The principal aspects of the new guidance are:

- Capital expenditure incurred or committed to before 26th November 2020 is allowable even for an 'investment asset primarily for yield'.
- Capital plans should be submitted by local authorities via a DELTA return. These open for the new financial year on 1st March and remain open all year. Returns must be updated if there is a change of more than 10%.
- An asset held primarily to generate yield that serves no direct policy purpose should not be categorised as service delivery.
- Further detail on how local authorities purchasing investment assets primarily for yield can access the PWLB for the purposes of refinancing existing loans or externalising internal borrowing.
- Additional detail on the sanctions which can be imposed for inappropriate use of the PWLB loan. These can include a request to cancel projects, restrictions to accessing the PLWB and requests for information on further plans.

23. **CHANGES TO PWLB TERMS AND CONDITIONS FROM 8th SEPTEMBER 2021;**

- The settlement time for a PWLB loan has been extended from two workings days (T+2) to five working days (T+5). In a move to protect the PWLB against negative interest rates, the minimum interest rate for PWLB loans has also been set at 0.01% and the interest charged on late repayments will be the higher of Bank of England Base Rate or 0.10%.
- UK Infrastructure Bank: £4bn has been earmarked for lending to local authorities by the UK Infrastructure Bank which is wholly owned and backed by HM Treasury. The availability of this lending to local authorities, for which there will be a bidding process, is yet to commence. Loans will be available for qualifying projects at gilt yields plus 0.6%, which is 0.2% lower than the PWLB certainty rate.

CAPITAL BORROWINGS AND DEBT RESCHEDULING

24. 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 does not envisage that any new long term borrowing will be required in 2021/22.

25. Current PWLB lending terms have severely constrained the option to generate savings via debt rescheduling. A significant rise in long term interest rates is required before rescheduling of debt is viable. However, interest rate structures are continually monitored for opportunities to generate savings from debt rescheduling. Any rescheduling that takes place will be reported to Members in monitoring reports.

ANNUAL INVESTMENT STRATEGY

26. The investment strategy for 2021/22 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with DCLG Guidance 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.

27. Investments have been made with various counterparties including UK and foreign banks with higher credit ratings, the larger Building Societies, “nationalised” banks and AAA rated money market funds. This diversity has enabled reasonable returns in a low interest rate environment. In the period 1st April to 30 September 2021 the average rate of return achieved on average principal available was 0.09 %. This compares with an average seven day deposit (7 day libid) rate of -0.08 %.

28. The credit ratings and individual limits for each institution within the categories of investments to be used by the Authority in 2021/22 are as follows:

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

29. The Authority had investments of £61.95m as at 30th September 2021 (this included a £33.81m firefighters’ pension grant received in July that will be utilised in the year):

Institution	MM Fund	Bank / Other	D M A D F	Building Society	Local Authority
	£	£	£	£	£
Aberdeen	3,000,000			-	-
aberdeenshire council					
Ashford BC					2,000,000
Bank of Scotland (HBOS)					
Birmingham CC	-			-	
Blackburn with Darwen					
Blackpool Council					2,000,000
Blackrock-HERITAGE		-	-	-	
Broxbourne District Council					
Broxtowe Council					
CCLA	3,000,000				
City of Kingston Upon HULL	-		-	-	3,000,000
Close Brothers	-	-	-	-	
Coventry B Soc	-	-		2,000,000	
Cumberland B Soc	-	-		1,000,000	
DGLS		-	-	-	
DMADF			15,000,000		
Eastleigh BC					
Federated Investors UK	3,000,000	-	-	-	
Fidelity ICF	3,000,000	-	-	-	
Flintshire				-	
Goldman Sachs			-	-	
Goldman Sachs	-			-	
Goldman Sachs - SLRF		-		-	
Guildford BC					
Gwent Borough Council				-	
Handelsbanken	-	-	-	-	
Highland Council				-	
HBOS FTD	-	-	-	-	
HBOS FTD	-	-	-	-	
HSBC INST ACCESS DEPOSIT ACCOUNT		3,950,000			
JP Morgan		-	-	-	
Lancashire County Council				-	
Leeds B Soc				2,000,000	
LGIM		-		-	
London Fire Commissioner	-			-	2,000,000
Morgan Stanley	3,000,000	-		-	
myrthyr tydfil cbc	-	-		-	
Nationwide B Soc				2,000,000	
Newcastle B Soc	-	-		2,000,000	
North Lanarkshire					2,000,000
Nottingham B Soc	-				
PCC Lancashire					
Principality B Soc	-			1,000,000	
Progressive B Soc	-	-		-	
Salford				-	
Santander		2,000,000		-	
Schroders		-		-	
Skipton B Soc		-			
Slough Bc				-	
Surrey Heath B C					2,000,000
Standard life Investors (Ignis)	-	-		-	
Sumitomo		2,000,000		-	
Tameside MBC					
Thurrock Council					
West Brom B Soc		-		1,000,000	-
Wirral BC					
Yorkshire B Soc		-		-	-
Totals	15,000,000	7,950,000	15,000,000	11,000,000	13,000,000
Total Current Investments				***30.09.2021***	61,950,000

EXTERNAL DEBT PRUDENTIAL INDICATORS

30. The external debt indicators of prudence for 2021/22 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt: £62 million
Operational boundary for external debt: £57 million

Against these limits, the maximum amount of debt that was reached in the period April to September 2021 was £36.9 million.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

31. The treasury management indicators of prudence for 2021/22 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 period April to September 2021 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 in the period April to September 2021 was as follows: -

Maturity Period	Upper Limit	Lower Limit	Maximum Actual	Minimum Actual
Under 12 months	50%	0%	8%	8%
12 months and within 24 months	50%	0%	1%	1%
24 months and within 5 years	50%	0%	0%	0%
5 years and within 10 years	50%	0%	0%	0%
10 years and above	100%	0%	91%	91%

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 2021/22. No such investments have been made in the first half of 2021/22.

PERFORMANCE INDICATORS

32. 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.

33. The indicators for the treasury function are:

Borrowing – the indicator is the average rate of actual borrowing compared to the average available for the period of borrowing. However, there has been no borrowing in the period April to September 2021.

Investments – Internal returns compared to the 7 day LIBID rate. The return in the period April to September 2021 was 0.17% above the benchmark. LIBID rates will no longer be available from the end of 2021. At this point the benchmark will change to the Sterling Overnight Index Average (SONIA), a rate administered by the Bank of England.

REVISIONS TO CIPFA CODES

34. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

35. In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes. The changes include:

- Clarification that (a) local authorities must not borrow to invest primarily for financial return (b) it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Categorising investments as those (a) for treasury management purposes, (b) for service purposes and (c) for commercial purposes.
- Defining acceptable reasons to borrow money: (i) financing capital expenditure primarily related to delivering a local authority's functions, (ii) temporary management of cash flow within the context of a balanced budget, (iii) securing affordability by removing exposure to future interest rate rises and (iv) refinancing current borrowing, including replacing internal borrowing.
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators
    - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
    - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
    - Excluding investment income from the definition of financing costs.
- Incorporating Environmental, Social, and Governance (ESG) issues as a consideration within Treasury Management Principle 1 Risk Management.

- Additional focus on the knowledge and skills of officers and elected members involved in decision making

MHCLG (DLUHC) IMPROVEMENTS TO THE CAPITAL FINANCE FRAMEWORK

36. MHCLG published a brief policy paper in July outlining the ways it feels that the current framework is failing and potential changes that could be made. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk".

37. The actions announced include greater scrutiny of local authorities and particularly those engaged in commercial practices; an assessment of governance and training; a consideration of statutory caps on borrowing; further regulations around Minimum Revenue Provision (MRP) and ensuring that MHCLG regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

38. A further consultation on these matters is expected soon.

TREASURY MANAGEMENT ADVISORS

39. 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 advisors 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.

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

CONCLUSION

41. Treasury Management activity in 2021/22 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.