APPENDIX A

TREASURY MANAGEMENT ANNUAL 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 regular reports to Members. This report represents the final report on Treasury Management for 2021/22.

2. The strategy for the year was identified in the Treasury Management Strategy Statement 2021/22. 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. The continuing economic recovery from coronavirus pandemic, together with the war in Ukraine, higher inflation, and higher interest rates were major issues over the financial year. The bank rate was 0.10% at the start of the financial year but rising inflation; driven by rising global costs, strong demand, supply shortages and a surge in wholesale gas and electricity prices; resulted in a series of interest rate rises towards the latter part of the financial year.

4. The Bank of England increased Bank Rate from 0.10% to 0.25% in December, then hiked it further to 0.50% in February and 0.75% in March. At the meeting in February, the Monetary Policy Committee (MPC) voted unanimously to start reducing the stock of its asset purchase scheme by ceasing to reinvest the proceeds from maturing bonds as well as starting a programme of selling its corporate bonds.

5. In its March interest rate announcement, the MPC noted that the invasion of Ukraine had caused further large increases in energy and other commodity prices, with the expectation that the conflict will worsen supply chain disruptions around the world and push CPI inflation to around 8% later in 2022, even higher than forecast only a month before in the February Monetary Policy Report. The Committee also noted that although GDP in January was stronger than expected with business confidence holding up and the labour market remaining robust, consumer confidence had fallen due to the squeeze in real household incomes.

6. Given the uncertainty throughout 2021/22 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.

7. PWLB rates and gilt yields have seen volatility over the course of the financial year, with long term PWLB rates varying from a low of 1.45% to a peak of 2.69%. At the start of the financial year long term PWLB rates were 2.23% and finished the financial year higher at 2.59%.

8. The Authority is not planning to borrow to invest primarily for commercial return and so is unaffected by changes to the Prudential Code. These changes are outlined in further detail later in this report.

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 (CFR) 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 2021/22 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 2021/22 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 2021/22 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 2021/22 was 0.11%. This compares with an average Sterling Overnight Rate (SONIA) of 0.14%.

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 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 reached at any time in the financial year 2021/22 was £36.9 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 (2020/21) plus the estimates of any additional capital financing requirement for the current (2021/22) 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 2021	**31 March 2022**	**31 March 2023**
	Actual	**Actual**	**Estimate**
	£’m	**£’m**	**£’m**
Capital Financing Requirement	52.2	54.4	73.2
Less: PFI	(17.3)	(16.8)	(16.4)
Less:MRD	(0.2)	(0.2)	(0.1)
Borrowing CFR	**34.7**	**37.4**	**56.7**
Existing Debt Portfolio	37.1	33.9	33.7
Over(-)/Under borrowing	**(2.4)**	**3.5**	**23.0**

Borrowing as a % of CFR	**106.9%**	**90.6%**	**59.4%**

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

16. 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 financial year 2021/22 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 2021/22 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%	1%	0%
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%	99%	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 investments longer than 365 days have been placed during 2021/22.

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 2021/22.

Investments – Internal returns compared to the average Sterling Overnight Rate (SONIA). The return in the financial year 2021/22 was 0.03% below 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.

Revised CIPFA Codes, Updated PWLB Lending Facility Guidance

21. In August 2021 HM Treasury significantly revised guidance for the PWLB lending facility with more detail and 12 examples of permitted and prohibited use of PWLB loans. 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. Acceptable use of PWLB borrowing includes service delivery, housing, regeneration, preventative action, refinancing and treasury management.

22. CIPFA published its revised Prudential Code for Capital Finance and Treasury Management Code on 20th December 2021. The key changes in the two codes are around permitted reasons to borrow, knowledge and skills, and the management of non-treasury investments.

23. The principles of the Prudential Code took immediate effect although local authorities could defer introducing the revised reporting requirements until the 2023/24 financial year if they wish. It is our intention to introduce the revised reporting requirements during 2023/24.

24. To comply with the Prudential Code, authorities must not borrow to invest primarily for financial return. This Code also states that it is not prudent for local authorities to make investment or spending decision that will increase the CFR unless directly and primarily related to the functions of the authority. Existing commercial investments are not required to be sold; however, authorities with existing commercial investments who expect to need to borrow should review the options for exiting these investments.

25. Borrowing is permitted for cashflow management, interest rate risk management, to refinance current borrowing and to adjust levels of internal borrowing.

Borrowing to refinance capital expenditure primarily related to the delivery of a local authority's function but where a financial return is also expected is allowed, provided that financial return is not the primary reason for the expenditure. The changes align the CIPFA Prudential Code with the PWLB lending rules.

26. Unlike the Prudential Code, there is no mention of the date of initial application in the Treasury Management Code. The TM Code now includes extensive additional requirements for service and commercial investments, far beyond those in the 2017 version.

27. This Authority will follow the same process as the Prudential Code, i.e. delaying changes in reporting requirements to the 2023/24 financial year.

IFRS 16

28. The implementation of the new IFRS 16 Leases accounting standard was due to come into force for local authorities from 1st April 2022. Following a consultation CIPFA/LASAAC has announced an optional two year delay to the implementation of this standard; a decision which was subsequently confirmed by the Financial Reporting Advisory Board in early April 2022.

CONCLUSION

29. 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.