APPENDIX A

TREASURY MANAGEMENT ANNUAL REPORT 2016/17

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 2016/17.

2. The strategy for the year was identified in the Treasury Management Strategy Statement 2016/17. 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 UK EU referendum in June 2016 and the outcome of the USA election in November 2016 had significant influence on financial markets in 2016/17. The prospects for a slowly rising base rate during the latter part of 2016/17 have now been pushed back until 2019, after the Brexit negotiations are expected to have been concluded. The Bank of England Monetary Policy Committee (MPC) cut the bank rate from 0.50% to 0.25% in August 2016 and the bank forecast economic growth to fall to almost zero in the second half of 2016. This forecast proved to be overly pessimistic as annual growth for 2016 compared to 2015 was 1.8%; almost the fastest rate of growth of any G7 country. Needless to say, this meant that the MPC did not cut the bank rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

4. During 2016/17 there was major volatility in Public Works Loans Board (PWLB) rates. Rates fell from April to June 2016 and gained fresh downward impetus after the referendum and the bank rate cut, before staging a partial recovery through to December and then falling slightly through to the end of March 2017. The overall movement during 2016/17 was that longer term PWLB rates fell by 0.61% from 3.15% at the start of the year to 2.54% at the end of the year.

5. The strategy indicated that the overall structure of interest rates whereby short term rates are lower than long term rates was expected to remain throughout 2016/17. In this scenario, the strategy would be to reduce investments and borrow for short periods and possibly at variable rates when required.

CAPITAL BORROWINGS AND DEBT RESCHEDULING

6. 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 2016/17 and no new borrowing was arranged. Market conditions continued to be unfavourable for any debt rescheduling.

ANNUAL INVESTMENT STRATEGY

7. The investment strategy for 2016/17 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.

8. 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 within the categories of investments used by the Authority in 2016/17 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

The average rate of return achieved on average principal available in 2016/17 was 0.57%. This compares with an average seven day deposit (7 day libid) rate of 0.20%.

9. 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

10. The external debt indicators of prudence for 2016/17 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£73 million
Operational boundary for external debt:	£61 million

Against these limits, the maximum amount of debt reached at any time in the financial year 2016/17 was £41.1 million.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

11. The treasury management indicators of prudence for 2016/17 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 2016/17 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 2016/17 was as follows:

Maturity Period	Upper Limit	Lower Limit	Maximum Actual	Minimum Actual
Under 12 months	50%	0%	5%	3%
12 months and within 24 months	50%	0%	2%	0%
24 months and within 5 years	50%	0%	10%	3%
5 years and within 10 years	50%	0%	8%	0%
10 years and above	90%	0%	86%	82%

c) Total principal sums invested for periods longer than 364 days

The limit for investments of longer than 364 days was set at £2 million for 2016/17. No such investments were placed during 2016/17.

PERFORMANCE INDICATORS

12. 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.

13. 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 2016/17.

    - Investments – Internal returns compared to the 7 day LIBID rate. The return in the financial year 2016/17 was 0.37% above the benchmark.

TREASURY MANAGEMENT ADVISORS

14. 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.

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

CONCLUSION

16. Treasury Management activity in 2016/17 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.