ANNEX I

2020/21 TREASURY MANAGEMENT Q2 (JUL-SEPT) UPDATE

1. Purpose

1.1. Local authorities are under legal obligation by the Local Government Act 2003 to have regard to the treasury risk management framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice 2017 Edition (the Code). The Council is also required to have regard to Ministry of Housing, Communities and Local Government (MHCLG) guidance in relation to Investments and Minimum Revenue Provision (MRP).

1.2. The Code requires, as a minimum, the Council to report:

a) an annual treasury strategy in advance of the year; this was presented to Council on 26/02/2020;
b) a mid-year (minimum) treasury update report (this report):
c) an annual report following the end of the year describing the activity undertaken compared to the strategy.

1.3. In line with best practice principles, the Council also presents quarterly update reports for Q1 (Cabinet 01/09/20) and Q3.

1.4. The CIPFA Prudential Code for Capital Finance in Local Authorities (2017 Edition) includes a requirement for local authorities to produce a Capital Strategy, a summary document to be approved by Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy was also approved by Council on 26/02/2020.

2. External Context

Economic background:

2.1. The Bank of England's (BoE) Monetary Policy Committee (MPC) kept Bank Rate unchanged at 0.10% during August and September. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in economic growth in the first half of 2020 was revised from -28% to -23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.

- The forecast peak in unemployment rate was revised down from 9% in Q2 to 7.5% by Q4 2020.

- It forecast that there would be excess demand in the economy by Q3 2022 causing inflation (CPI) to rise above its 2% target in Q3 2022 (based on expectations of further loosening in policy). Nevertheless, even if the BoE were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

2.2. The MPC also clarified its position on negative interest rates. It suggested that while negative rates can work in some circumstances, they would be less effective as a tool to stimulate the economy at this time when financial institutions are concerned about potential future loan losses. It has other instruments available, including further quantitative easing and the use of forward guidance, and so negative interest rates is seen as a last resort.

2.3. The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the turn of the year. This implies that the pace of purchases will slow.

2.4. On balance and with the economy was recovering better than expected, the MPC may not take immediate further action. However medium-term projections are a less informative guide of direction of travel than usual and downside risks persist in the short and medium-term.

2.5. The wind down of the Government furlough scheme through to the end of October is another development that could cause a need for more support for the economy later in the year. However, a second six-month package of support for job retention from November, along with further help for the self-employed, freelance and the hospitality industry, may provide some relief.

2.6. Overall, the pace of recovery is not expected to be in the form of a rapid bounce back but a more elongated and prolonged one, as even the sharp recovery in June to August still left the economy 11.7% smaller overall than it was in February. The last three months of 2020 are now likely to show no growth as consumers will likely remain cautious in spending and uncertainty over the outcome of the Brexit trade negotiations dampen sentiment.

2.7. One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect Bank Rate to rise unless it is <u>persistently</u> above target.

2.8. The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to somewhat less than £80bn. It stated that in its assessment, banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection with unemployment rising to above 15%.

2.9. Brexit uncertainties ahead of the end of December deadline are also likely to be a drag on recovery.

2.10. A further detailed economic commentary is shown at Appendix 1.

Financial markets:

2.11. Gilt yields - upon which Public Works Loan Board (PWLB) rates are derived - were already on a generally falling trend up until the coronavirus crisis hit western economies during March. After an initial spike in March, yields fell sharply in response to major western central banks taking rapid policy action to deal with excessive stress in financial markets and starting massive quantitative easing driven purchases of government bonds. These actions acted to put downward pressure on government bond yields at a time when there has been a huge and rapid expansion of government expenditure financed by issuing bonds. Such unprecedented levels of issuance in normal circumstances would have increased supply so caused bond yields to rise sharply. But at end of September, all gilt yields from 1 to 6 years were negative, while even 25-year yields were only at 0.76% and the 50 year at 0.60%.

3. Borrowing

3.1. The Council's primary objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should long-term plans change is a secondary objective.

3.2. Following the changes on 11th March 2020 in margins over gilt yields (G), the current situation is as follows:

- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- PWLB HRA Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB HRA Certainty Rate is gilt plus 80bps (G+80bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

3.3. HM Treasury launched a wide-ranging consultation on the PWLB's future direction to allow key stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support projects that meet certain qualifying criteria. Proposals include lower rates for authorities not engaged in 'debt for yield' activity, but restricting individual authorities access to PWLB entirely in a financial year in which 'debt for yield' is being pursued within the entire capital programme (regardless of financing means).

3.4. Officers took part in consultation discussions with HM Treasury and other Unitary authorities, and the Director of Finance and Resources responded to the consultation on behalf of the Council. The deadline was extended to 31st July 2020 with implementation of the new lending terms expected in the latter part of this calendar year or financial year beginning 2021/22. It is possible that the non-HRA Certainty Rate will be subject to revision downwards when changes are announced; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

3.5. Further updates will be presented through Treasury Management Update reports as they develop.

3.6. Tables 1 below sets out the profile of the Council's borrowing portfolio by source of loan:

Table 1: Borrowing profile at 30th September 2020 by loan source

Tenor Bucket	Market Loans		PWLB Loans		Total	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Liquid	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
< 1 Year	£5,000,000.00	33.3%	£5,190,006.85	1.2%	£10,190,006.85	2.2%
1 - 2 Years	£0.00	0.0%	£9,732,747.02	2.2%	£9,732,747.02	2.1%
2 - 5 Years	£0.00	0.0%	£39,648,657.81	8.8%	£39,648,657.81	8.6%
5 - 10 Years	£0.00	0.0%	£64,697,089.19	14.4%	£64,697,089.19	14.0%
10 - 20 Years	£0.00	0.0%	£141,933,076.58	31.7%	£141,933,076.58	30.6%
20 - 30 Years	£0.00	0.0%	£27,000,000.00	6.0%	£27,000,000.00	5.8%
30 - 40 Years	£0.00	0.0%	£109,000,000.00	24.3%	£109,000,000.00	23.5%
40 - 50 Years	£10,000,000.00	66.7%	£51,360,000.00	11.4%	£61,360,000.00	13.2%
> 50 Years	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
Total	**£15,000,000.00**	**100.0%**	**£448,561,577.45**	**100.0%**	**£463,561,577.45**	**100.0%**

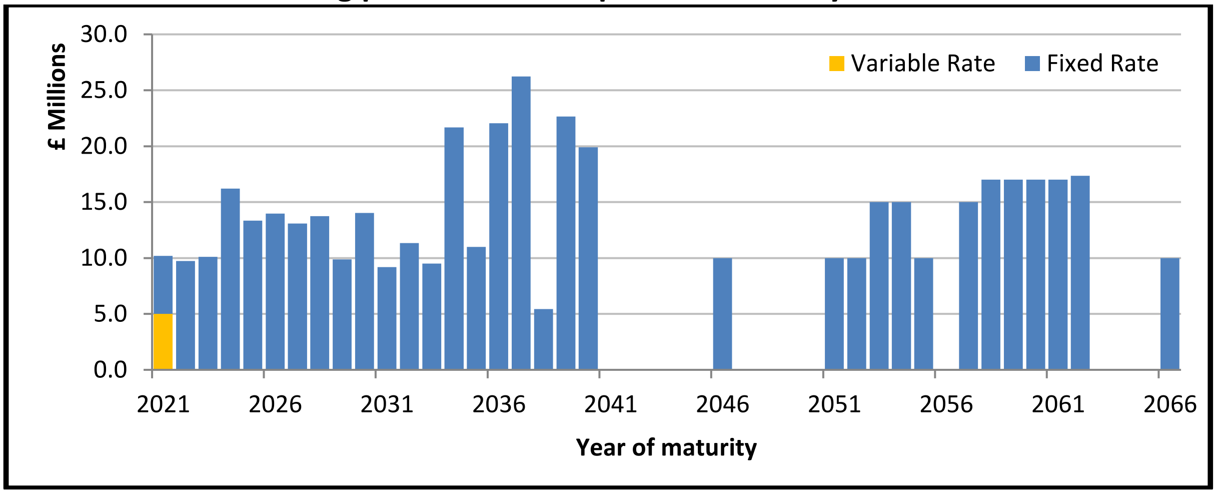
3.7. Tables 2 below sets out the profile of the Council's borrowing portfolio by interest rate structure/exposure:

Table 2: Borrowing profile at 30th September 2020 by interest rate structure

Tenor Bucket	Fixed Rate Loans	% of Total	Variable Rate Loans	% of Total	Total	% of Total
Liquid	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
< 1 Year	£5,190,006.85	1.1%	£5,000,000.00	100.0%	£10,190,006.85	2.2%
1 - 2 Years	£9,732,747.02	2.1%	£0.00	0.0%	£9,732,747.02	2.1%
2 - 5 Years	£39,648,657.81	8.6%	£0.00	0.0%	£39,648,657.81	8.6%
5 - 10 Years	£64,697,089.19	14.1%	£0.00	0.0%	£64,697,089.19	14.0%
10 - 20 Years	£141,933,076.58	31.0%	£0.00	0.0%	£141,933,076.58	30.6%
20 - 30 Years	£27,000,000.00	5.9%	£0.00	0.0%	£27,000,000.00	5.8%
30 - 40 Years	£109,000,000.00	23.8%	£0.00	0.0%	£109,000,000.00	23.5%
40 - 50 Years	£61,360,000.00	13.4%	£0.00	0.0%	£61,360,000.00	13.2%
> 50 Years	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
Total	**£458,561,577.45**	**100.0%**	**£5,000,000.00**	**100.0%**	**£463,561,577.45**	**100.0%**

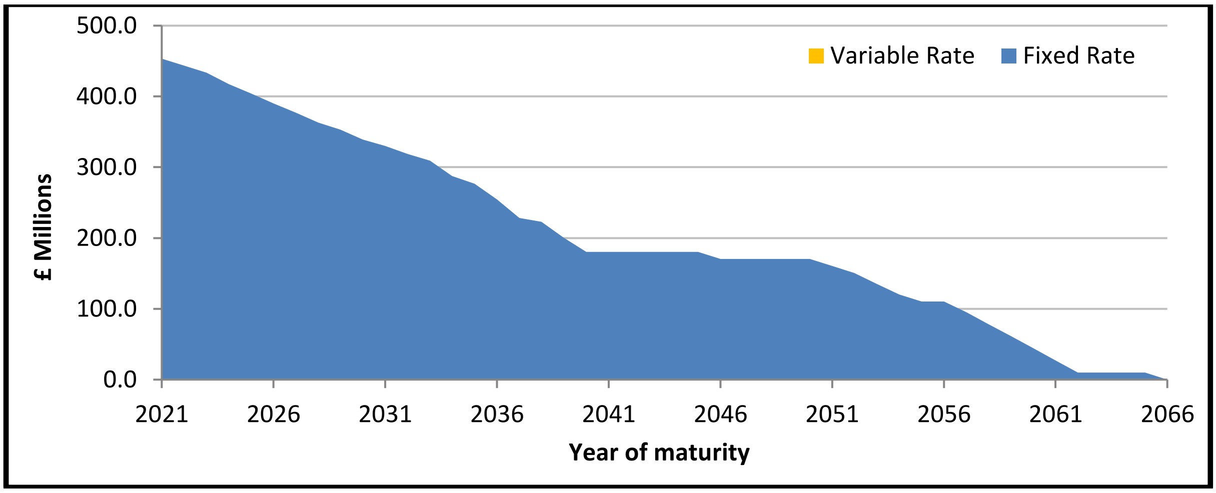
3.8. Chart 1 below shows the annual maturity profile of the Council's borrowing portfolio:

Chart 1: Borrowing profile at 30th September 2020 by annual maturities



3.9. Chart 2 below shows the fallout structure of the Council's borrowing portfolio:

Chart 2: Borrowing profile at 30th September 2020 by cumulative annual maturities



3.10. No new borrowing was undertaken during Q2.

3.11. PWLB principal repayment of £1.837m were made; a legacy 30 year loan for £0.414m that carried a 10.875% interest rate reached maturity at the end of September, and scheduled repayment of £1.423m were made against 10 annuity loans. As a result, the weighted average rate across the Council's borrowing portfolio at 30th September 2020 dropped to 4.34% (4.35% in Q1).

3.12. The Council continues to hold a £5m Lender's Option Borrower's Option (LOBO) loan where the lender has the option every 6 months to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. Treasury management practice is to present such loans at their next potential maturity date (in this case a rolling 6-month exposure) rather than their backstop maturity date (in this case November 2041). Given underlying market conditions the lender did not exercise their option during the quarter and is not expected to do so soon, so officers are considering this loan to be long term funding.

4. Debt Restructuring

4.1. No debt rescheduling was undertaken during the quarter. Debt rescheduling opportunities have been limited due to the current economic climate and consequent structure of interest rates. Officers and the Councils treasury advisors continue to monitor this position.

5. Housing Revenue Account (HRA) Debt Pooling arrangements

5.1. The 1st April 2012 saw the introduction of the Housing Self-Financing regime. As previously reported this Council adopted a single pool approach, whereby the Council manages its overall debt as a single portfolio and apportions costs to the General Fund (GF) and HRA at a consolidated rate in proportion to the debt held by each.

5.2. By adopting a single pool approach, any borrowing decisions by the GF impact upon the consolidated rate and therefore the debt costs apportioned to the HRA, and vice versa. As long as borrowing decisions are relatively balanced, then the impact is mitigated.

5.3. But on 30th October 2018, the Government removed the imposed debt caps which restricted how much housing authorities could borrow against their HRA. This opens up significant freedoms for additional borrowing by the HRA to support housing regeneration and new housing stock build programmes subject to the usual assessment criteria of the Prudential Code in demonstrating affordability, prudence and sustainability. In addition the Council would need to establish a clear metrics for assessing HRA debt that may include commercial costing measures such as capital risk buffers, debt interest cover ratios and loan-to-value limits.

5.4. This increased capacity for significant HRA borrowing means that the Council's single pool approach to managing debt may no longer be most appropriate, and the GF and HRA may be better suited pursuing separate debt strategies. Officers, in consultation with the Council's treasury advisors, are refining proposals present to Cabinet on 01/09/2020 to change to a two-pool approach to future debt management arrangements before a final decision is made in February 2021.

6. Annual Investment Strategy

6.1. The Treasury Management Strategy Statement (TMSS) for 2020/21, which includes the Annual Investment Strategy, was approved by the Council on 26th February 2020. It sets out the Council's fundamental investment priorities as being (in order):

1. **S**ecurity of Capital;
2. **L**iquidity; and
3. **Y**ield

6.2. The Council's investment activity during the quarter conformed to the approved strategy, and the Council had no difficulties meeting its liquidity requirements.

6.3. The Council's investment portfolio represents the short-term holding of positive cashflows at any given time, plus prudent medium and long term provisions, balances and reserves. During the quarter, the Council's investment balances ranged from a low of £302.3m to a high of £334.6m, in part due the receipt and distribution of coronavirus related funding as well as normal cashflow timing differences between income and expenditure. The average balance held was £310.8m. Table 3 below shows the Council's investment maturity position at 30th September 2020:

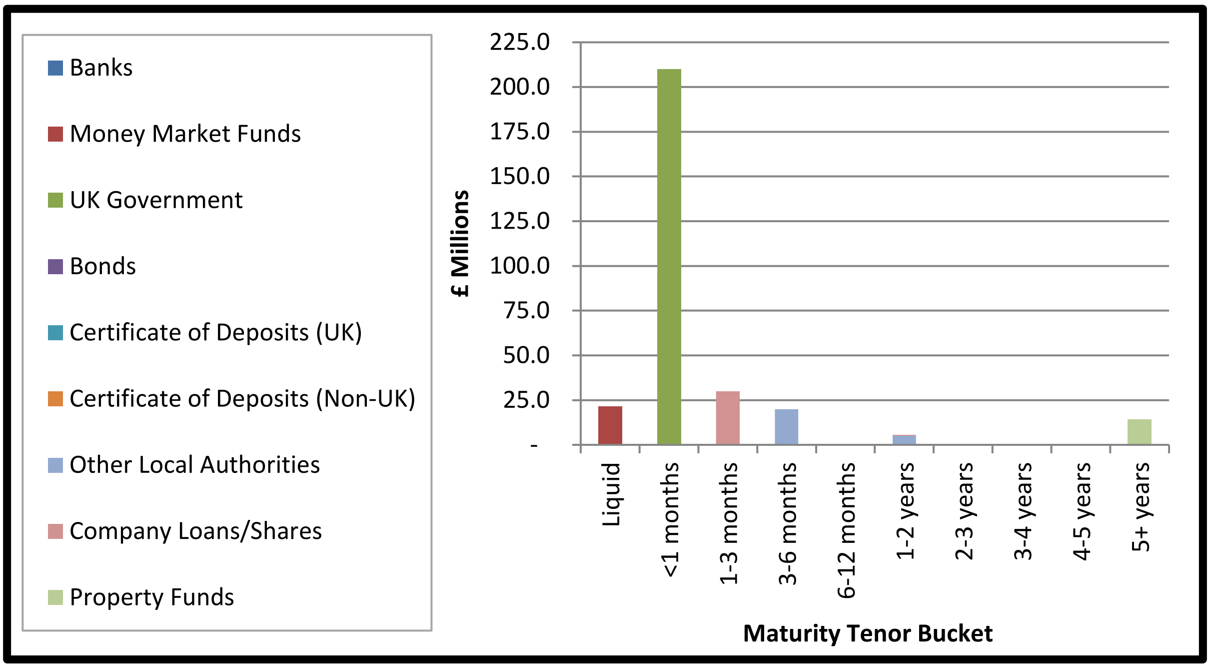
Table 3: Investment Maturity Position at 30th September 2020

Counterparty	Start Date	Maturity Date	Interest Rate	Interest Rate Structure	Principal O/S (£)
Same-day access: Banks					
Barclays Bank plc	n/a	n/a	0.0000%	Variable	15,013.45
National Westminster Bank plc	n/a	n/a	0.0100%	Variable	26.98
Handelsbanken plc	n/a	n/a	0.2000%	Variable	2,303.85
					17,344.28
Same-day access: Money Market Funds					

Counterparty	Start Date	Maturity Date	Interest Rate	Interest Rate Structure	Principal O/S (£)
Federated	n/a	n/a	0.2452%	Variable	6,470,000.00
Aberdeen	n/a	n/a	0.2426%	Variable	15,000,000.00
					21,470,000.00
UK Government:					
Debt Management Office	14/09/20	05/10/20	0.0100%	Fixed	120,000,000.00
Debt Management Office	21/09/20	12/10/20	0.0100%	Fixed	40,000,000.00
Debt Management Office	28/09/20	28/10/20	0.0100%	Fixed	50,000,000.00
					210,000,000.00
Other Local Authorities:					
Folkestone and Hythe District	25/03/20	25/03/21	1.6500%	Fixed	5,000,000.00
South Somerset District Council	27/03/20	26/03/21	1.6000%	Fixed	5,000,000.00
Telford and Wrekin Borough Council	25/03/20	31/03/21	1.6500%	Fixed	5,000,000.00
Armagh City Banbridge and Craigavon Borough Council	27/03/20	31/03/21	1.6000%	Fixed	1,000,000.00
Gwynedd County Council	30/03/20	31/03/21	1.6000%	Fixed	4,000,000.00
Cheshire West and Chester Council	31/03/20	31/03/22	1.8000%	Fixed	5,000,000.00
					25,000,000.00
Company Loans/Shares:					
Milton Keynes Development Partnership LLP	12/11/19	12/11/20	2.7700%	Fixed	30,000,000.00
YourMK LLP (shares)	09/08/16	n/a	0.0000%	Fixed	100.00
YourMK LLP	09/08/16	09/08/22	3.8116%	Variable	561,205.26
					30,561,305.26
Property Funds (variable net asset value [VNAV]):					
CCLA Local Authorities Property Fund	30/03/15		4.3038%	Variable	9,699,861.74
CCLA Local Authorities Property Fund	26/02/16		4.3038%	Variable	4,560,859.19
					14,260,720.93
					301,309,370.47

6.4. Chart 3 below shows the investment portfolio maturity profile by tenor buckets per category type at 30th September 2020:

Chart 3: Investment profile at 30th September 2020 by maturity category & tenor buckets

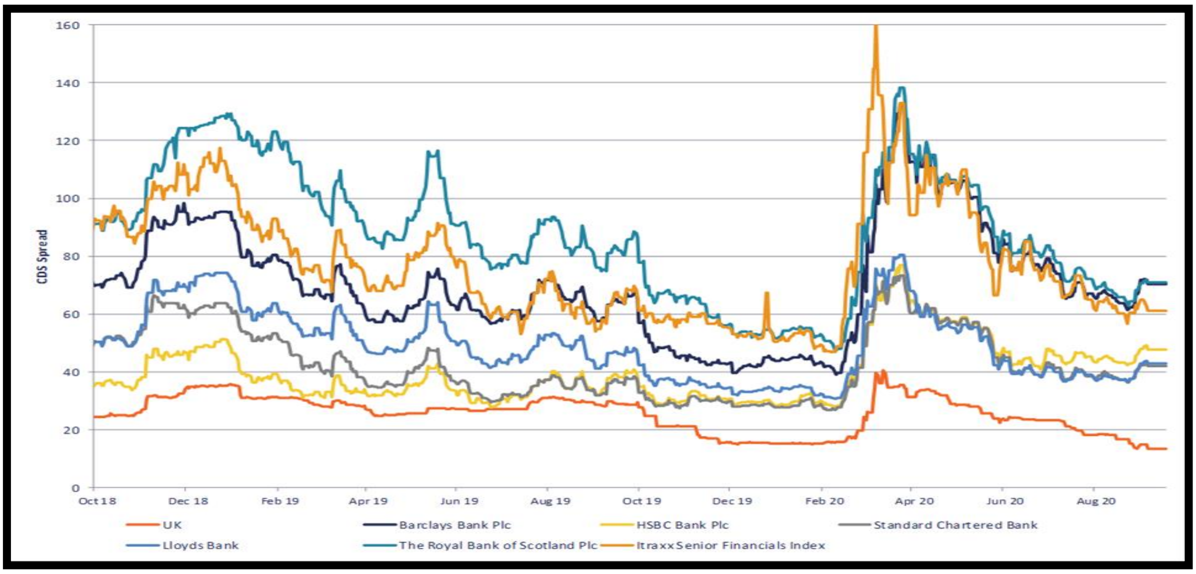


Credit background:

6.5. In addition to credit ratings and market intel, officers monitors price spreads on credit default swaps (CDS) – the market-traded insurance against borrower defaults. By their nature credit ratings are reactive, whereas the CDS market is live and demonstrates confidence in financial institutions in real-time, with sharp or sustained rises seen as an early warning indicator.

6.6. Chart 4 below plots spreads on CDS's over the past two years. After rising sharply in late March, spreads have eased but remained above their pre-crisis levels.

Chart 4: UK Banks 5 Year senior debt CDS spreads



6.7. Although credit rating agencies changed their rating watch outlooks on many UK banks from stable to negative during Q1 - due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic - the majority of ratings have been affirmed due to the continuing strong credit profiles of UK banks. However, during Q1 and Q2 2020, banks did make provisions for expected credit losses. As we move into Q3 and Q4, more information will emerge on actual levels of credit losses. This has the potential to cause rating agencies to revisit their ratings later in 2020. These adjustments could be negative or positive, although for context UK banks went into this pandemic with strong balance sheets. As stated in paragraph 2.8 above, the FPC report in August revised down expected credit losses for the banking sector to somewhat less than £80bn citing that, in their assessment, banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

6.8. There is a similar picture for non-UK banks, with being placed on negative watch outlooks but only a small number of actual rating downgrades.

6.9. Stress testing on the Council's indicative counterparties list shows that for a 1 notch downgrade to all Long-Term Ratings from all agencies, 6 counterparties would no longer be considered for new investments. However, a further 17 counterparties would see their suggested durations reigned in but would remain potentially available for use. Note for comparative purposes that this scenario is based on credit ratings alone, overlaying potential movement in CDS spreads may as ever exasperate any restrictions applied.

6.10. Restricting the number of counterparties and duration of investment under consideration as a risk-aversion action is necessary but does consequently severely restrict options available to the Council and rate of return. It is likely therefore in the short-term that the Council's holdings with the UK Government's Debt Management Office (no upper counterparty limit) will continue to remain significant.

6.11. The Council also utilises AAA rated Money Market Funds for short-term liquid cash investments. These pooled funds represent well-diversified, same-day access options with assets under management usually in the tens of billion pounds at any given time from many business sectors, including local authorities. Each fund with assets of more than one billion pounds under management is considered by the Council as comparatively secure as its peers, yet the Council limits investments to up to £15m per fund to spread counterparty risk. Officers continue enhanced monitoring of the performance of these funds given the widespread financial market volatility. The difference in return between individual fund remains marginally low, so in this heightened state of alert, added emphasis is instead being placed on the stability of each fund's underlying total assets.

Negative investment rates:

6.12. To date, the Council has always achieved a positive return on its investments. While the BoE has indicated it is unlikely to introduce a negative Bank Rate, at least in the next 6 to 12 months, some deposit accounts are already offering negative rates for shorter periods. And with most of the Council's investment portfolio highly liquid, negative returns is a significant risk.

6.13. As part of the response to the coronavirus pandemic and lockdown, the BoE and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. At the same time, the Government has provided large sums of grants to local authorities to help deal with the coronavirus crisis, which temporarily inflated cash balances until those sums were able to be passed on.

6.14. The need to prioritise security of capital and maintain liquidity in these unprecedented times has meant there is a glut of money swilling around at the very short dated range of the market. This has seen several market operators, now including the Debt Management Office, offer zero or negative returns for short term maturities.

6.15. This is not entirely universal just yet. Some high creditworthy financial institutions and money market funds are still offering marginally positive return - the latter by reducing or waived management fees to ensure that net yields for investors remain above zero where possible and practical - but that may not remain the case. Ordinarily there would be little value in the trade-off between keeping investments short and liquid against depositing for an extended period at elevated risk for a marginal return, but this may become necessary as a means of preserving capital.

6.16. Inter-local authority lending and borrowing rates have also severely declined due to the surge in the levels of cash seeking a short-term home, mostly due to many local authorities balancing difficulties over accurately forecasting cashflows and funding requirements against potential for further large-scale injections of cash from Government.

Externally managed strategic funds:

6.17. The Council invested a cash sum of £15m into an externally managed strategic pooled property fund with the CCLA; £10m in March 2015 and a further £5m in February 2016. Short-term security and liquidity are lesser considerations for this type of investment with the primary objectives instead being regular revenue income and long-term price stability.

6.18. At 30th September 2020, the Council's holdings had decreased to £14.261m (£14.288m at 30th June), representing a £0.027m fall in fair value. Excluding accrued interest, this fair value is £0.739m lower than the Councils initial £15.0m cash investments, which represents an unrealised loss. The Council has no plans to liquidate this investment and expect the funds value to recover in time.

6.19. In March 2020, CCLA suspended purchase and redemption transactions in direct response to the pervasive effects of Covid-19 coronavirus. Sharp falls in economic activity and relative infrequency of transactions in the property sector mean that it is not possible for the CCLA's valuers to be confident that their valuations will truly reflect prevailing conditions at this time.

6.20. This temporary suspension has now been lifted, but with the ongoing introduction of a redemption notice period of 90 days. This does not have an immediate or significant impact on the Councils investment, which has always been treated its holdings as a strategically long term. During the period of suspension, the Council continued to accrued full dividend returns but received approximately 75% in cash with the remaining 25% deferred until later this financial year.

6.21. The CCLA takes a distinct approach to its asset acquisitions in that it does not buy assets simply for short-term gain, but a diversified range of long-term and adaptable assets that could, in most cases, be repurposed. Evidence so far suggests the current impact upon commercial property markets is contained and focused on those already underperforming specific sub-categories like, high street retail. The reality is that retail markets were evolving this way beforehand, and this crisis has simply accelerated those trends. Other than housing, there is high demand for long-term commercial warehousing as well as flexible multi-purpose office spaces.

6.22. Officers receive regular updates from the CCLA fund management team. The fund effectively entered this period of global crisis from the impact of coronavirus from a well-managed base risk position, on back of over a decade of market instability since the 2008 financial crisis as well as the more recent and continuing heightened risks surrounding Brexit.

Investments for policy reasons outside of normal treasury management operations:

6.23. Although not classed as treasury management activities per se, the 2017 CIPFA Code now requires the Council to report on investments for policy reasons outside of normal treasury management operations. This includes service investments for operational and/or regeneration as well as commercial investments made primarily for financial income reasons. These investments typically earn a higher rate of return compared to normal treasury management investments, which reflects the additional risks that the Council is exposed to.

6.24. The Council has advanced a £30.0m 1-year loan to its wholly owned subsidiary company Milton Keynes Development Partnership (MKDP) LLP, used to finance the acquisition of assets from the Homes and Communities Agency (HCA) in 2012/13. The loan rate of 2.77% was set with reference to State Aid regulations and prevailing market rates. This loan matured in November 2020 and a direct replacement has been agreed under the same terms for a further 1-year at 2.63% to mature in November 2021.

6.25. The Council has also lent £0.5m in tranche payments to its 50% joint-owned partnership company YourMK LLP. YourMK is a partnership between the Council and Mears Group to deliver regeneration, management of council housing stock, and other development on council land and it is responsible for all Housing Land under the Council. At 30th September 2020, the Council's investment holding was valued at £0.561m, of which £0.061m represents an unrealised gain through accruing compound interest since advanced.

6.26. The Council holds a £5.0m principal investment (match-funded by external investment) in a National Homelessness Property Fund, the assets of which are for use as housing temporary accommodation in Milton Keynes. Accepting that this investment constitutes a greater risk than traditional treasury management investments, a return of £0.024m was made in Q1 this year (awaiting Q2 figures), representing a rate of return of 1.92%. This investment is not shown within the tables and charts above as it was funded through the capital programme and reported through the capital monitoring process.

Investment income performance:

6.27. Investment income performance against the 3-month London Interbank Bid Rate (LIBID), which is the bidding rate at which banks are willing to borrow from each other, is shown in Table 4 below. Income return projections for the financial year are reported through the Budget Monitoring process and although investment returns are lower than expected, the amount of cash the Council holds is higher than anticipated when setting the 20/21 budget, with the two directly offsetting each other.

Table 4: Investment income performance against 3-month LIBID benchmark

Period	MKC Performance	Benchmark Performance	Difference
Q1 (Apr-Jun)	0.94%	0.26%	+0.68%
Q2 (Jul-Sept)	0.64%	0.11%	+0.53%
Mid-Year	**0.78%**	**0.21%**	**+0.57%**

7. Outlook for the remainder of 2020/21

7.1. Bank Rate is not expected to change from 0.10% within a forecast horizon ending on 31st March 2023, as the economic recovery is expected to be only gradual and prolonged. Additional monetary loosening through quantitative easing is highly likely.

7.2. As outlined above, negative returns on the Councils investments is a significant risk, and mitigating actions will be taken where possible.

7.3. The medium-term global economic outlook remains very weak. It is likely to be some time before consumer spending patterns recovers to pre-crisis levels due to rises in unemployment, the potential on-going need for virus control measures and the impact on consumer/business confidence. The responses from the BoE, HM Treasury as well as other central banks and governments have been significant and will act to support recovery.

7.4. Gilt yields are expected to remain very low in the medium term. Some shorter-term gilt yields will remain negative or close to zero until growth prospects improve.

7.5. Brexit remains a further prominent economic risk and so far, no agreement has been reached. A no-deal on 31st December could lead to a reduction in economic growth depending on the type of no-deal scenario, setting back the UK's recovery from recession.

8. Change of Treasury Advisors

8.1. In August 2020, the Council undertook a competitive market procurement tender to appoint treasury and leasing advisors on a 3-year contract with a possible up-to 2-year extension period. The contract has been awarded Link Asset Services.

9. Compliance with Treasury and Prudential Limits

9.1. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators are set as part of the Treasury Strategy and Capital Strategy.

9.2. During the quarter the Council has operated within its treasury limits and Prudential Indicators, shown in Table 5 below.

Table 5: Prudential and Treasury Indicators

Prudential Indicator	2020/21 Indicator	Q2 2020/21
Authorised limit for external debt	----- £770.000m -----	
Operational boundary for external debt	----- £740.000m -----	
Gross borrowing	£458.372m	£463.562m
Capital Financing Requirement (CFR)	£709.081m	£709.055m
Ratio of financing costs to net revenue streams: GF	8.82%	8.81%
HRA	37.50%	37.50%
Limit of fixed interest rates based on net debt	£770.000m	£193.562m
Limit of variable interest rates based on net debt	£77.000m	-£31.309m
Principal sums invested > 365 days	£75.000m	£19.839m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	2.2%
12 months to 2 years	Max. 15% Min. 0%	2.1%
2 years to 5 years	Max. 50% Min. 0%	8.6%
5 years to 10 years	Max. 50% Min. 0%	14.0%
10 years and above	Max. 100% Min. 50%	73.1%

DETAILED ECONOMIC COMMENTARY – Q2 2020/21

1. During the quarter ended 30th September 2020 (quarter 3 of 2020):
    - There was a quicker-than-expected recovery in GDP in June and July;
    - Retail spending rose 4.0% above its pre-virus level, but the recovery in investment lagged behind;
    - There was a second wave of the virus and a tightening in COVID-19 restrictions in September;
    - In September, the Chancellor announced further fiscal measures to support the economy;
    - Concerns about a second wave and a no deal Brexit weighed on the FTSE 100 and the pound;
    - There were divisions on the Bank of England's Monetary Policy Committee (MPC) over the possible use of negative interest rates;

2. The initial economic recovery appears to have been quicker than anticipated. Gross Domestic Product (GDP) rose by 2.4% month-on-month (m/m) in May as manufacturing and construction work resumed, by 8.6% m/m in June as non-essential retail stores reopened, and by 6.6% m/m in July as pubs and restaurants reopened. The rise in the all sector Purchasing Managers Index (PMI) in August suggests that recovery continued at a strong pace.

3. Consumer spending appears to have recovered strongly. Retail sales rose by 0.8% m/m in August, pushing them 4.0% above their pre-pandemic level. The mini-boom in the housing market meant transactions rose by 28.9% year-on-year (y/y) in August. Nationwide house prices rose by 0.9% m/m in September, which pushed up the annual rate to 5% – a four-year high. The Eat Out to Help Out, (EOHO), restaurant discount scheme and pent-up demand, also suggest that non-retail spending did well in August.

4. But this strength largely reflects the Government's fiscal support since March. It is encouraging that the bulk of the 4 million workers that have come off the furlough scheme between May and the end of July have gone back to their jobs rather than into unemployment or inactivity.

5. Even so, there have been signs that households' appetite for credit is waning. Consumer credit rose by only £0.3bn in August compared to July's £1.1bn rise. Admittedly, it could be that consumers are just using cash saved during lockdown to finance big ticket purchases. Indeed, the household saving rate surged from 9.6% in Q1 to a record-high of 29.1% in Q2. But consumer confidence has also weakened, slipping from -16.6 in August to -17.9 in September.

6. What’s more, having fallen by 26.5% quarter-on-quarter (q/q) in Q2, business investment still seems to be well below pre-pandemic levels. According to the latest Office for National Statistics (ONS) Business Impact of the COVID-19 Survey (BICS), 38% of businesses said their plans to expand had been scaled back or cancelled since the pandemic. And the Bank of England’s Agents survey suggested that investment intentions remain close to their record lows.

7. Meanwhile, there have been worrying signs that activity started to drop in September. Footfall on UK high streets had fallen to -45% y/y by mid-September. And despite not even having returned to its pre-crisis level, seasonally adjusted car production dropped by 24% m/m in August.

8. Further Government fiscal support was announced in September. The centrepiece of the Winter Economic Plan (WEP) was the six-month long “Job Support Scheme” starting on 1 November. Under the scheme, the Government will pay a maximum of 22% of worker’s salaries and the company pays a minimum of 55%, as long as the employee is working a third of normal hours. The WEP also included an extension of the VAT cut for hospitality/tourism from 20% to 5% from 13 January to 31 March. It is estimated these new measures will probably cost around £5bn, bringing the total cost of the Government’s direct fiscal measures to about £220bn (10% of GDP 2019).

9. The mounting fiscal cost of the crisis is being reflected in public finance figures. The Government borrowed £35.9bn in August, leaving borrowing in the year to date at £173.5bn (the highest cash figure on record, with seven months of the financial year still to go - the previous record was £158.3bn in 2009/10). Add in the effects of the weak economy and borrowing could end up at £370bn (18.4% of GDP) in total in 2020/21.

10. But the new package is unlikely to fully offset the hit to GDP and employment from the Government’s COVID-19 restrictions. Indeed, the UK has begun to grapple with a second wave of coronavirus infections.

11. The Bank of England are expected to ease monetary policy further. Admittedly, the sharp drop in inflation (CPI) from +1.0% in July to +0.2% in August, due to the effects of the cut in VAT for hospitality/tourism and August’s EOHO restaurant discount scheme, probably represents the low point for inflation. We expect inflation (CPI) to have risen to +0.6% in September and it could temporarily rise to 2.0% at the end of 2021. But the big picture is that it will be a few years before the economy is strong enough to sustain inflation (CPI) at the Bank of England’s 2% target.

12. In its September minutes, the MPC commented that it “had been briefed on the Bank’s plans to explore how a negative Bank Rate could be implemented effectively”. MPC member Silvana Tenreyro noted the “encouraging” evidence

on the use of negative rates in Japan and the euro-zone. But Bank of England Governor Andrew Bailey and others have talked down the prospect. So, for the next 6-12 months, it is likely that further quantitative easing will remain the tool of choice and that another £250bn could be used over the next year, significantly more than previously forecast.

13. There are two key downside risks to this outlook:
    i. The first of these is the possibility that restrictions are tightened much further to contain the spread of coronavirus. This would also increase the possibility that the Bank of England has to do more at a later stage.
    ii. The second risk is a no deal Brexit at the end of the transition period on 31st December 2020.

14. The concerns about the consequences for the economy from a second wave of COVID-19 and a no deal Brexit have reduced the FTSE 100 almost back to May's level and weakened the pound from $1.35 to $1.28. Some spreads of corporate bonds over gilt yields have started to tick up. With COVID-19 and a no deal Brexit risks rising, the risks that the FTSE 100 will rebound to its pre-crisis level by the end of 2022 and that the pound will climb back to $1.35 if there is a Brexit deal are firmly on the downside.

15. In the euro-zone, there is further evidence that the economic recovery is grinding to a halt. This has resulted in short time working policies being extended in Europe's Big Four until the end of the year at a minimum. And there is a good chance that the European Central Bank will provide additional stimulus soon.

16. The continued economic recovery in the US in the face of its second wave in June and July has been impressive, but GDP remains below pre-virus levels. And while the Federal Bank adopted "a flexible form of average inflation targeting" in August, it has offered no hints it is contemplating adding more stimulus soon. But the calls for more stimulus may grow louder if the recovery slows, particularly if Congress cannot agree on more fiscal support.