Cabinet

12 November 2020

Treasury Management Monitoring Report

Recommendation

That the Cabinet notes and comments on Treasury Management activity and performance in respect of the first six months of 2020/21.

1 Executive Summary

1.1 The Treasury Management Strategy sets out that Council delegates to Cabinet responsibility for receiving and reviewing monitoring reports and acting on recommendations in respect of treasury management.

1.2 This report provides an update on treasury management activity and performance for the first six months of the year.

1.3 The following headlines are detailed in the report:

- Cash balances have risen by £25.6m.
- Investment returns have been reducing due to the impact of Covid on interest rates. There will be a significant shortfall in investment returns (estimated to be £1.7m) compared to budget by the year end. This will be covered by the interest rate volatility reserve.
- Security and liquidity continue to be the priority for investment balances. No credit defaults or liquidity issues have been experienced.
- £10m of long-term debt has been repaid, and no new debt has been taken out.
- Borrowing has remained within prudential limits.
- No changes to strategy are recommended, however a revised Treasury Strategy will be presented to Cabinet for recommendation to Council in December, in relation to new investment options and opportunities.

2. Treasury Management

2.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet cash expenditure. Part of the purpose of treasury management operations is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 Accordingly, Treasury Management is defined by the CIPFA Code of Practice as:

- *"The management of the local authority's borrowing, 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."*

2.4 This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017). The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Resources and Fire & Rescue Overview and Scrutiny Committee.

2.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and includes coverage of the following:

- An economic update for the first half of the 2020/21 financial year (Appendix E);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 3);
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators (Section 6 and Appendix H of this report, and capital spending is reported in more detail elsewhere on this meeting's agenda);
- A review of the Council's investment portfolio for 2020/21 (Section 4);
- A review of the Council's borrowing strategy for 2020/21 (Section 5);
- A review of any debt rescheduling undertaken during 2020/21 (Section 5);
- A review of compliance with Treasury and Prudential Limits for 2020/21 (Section 6).

3 Treasury Management Strategy and Annual Investment Strategy

3.1 The Treasury Management Strategy Statement, (TMSS), and Investment Strategy (IS) for 2020/21 were approved by Council on 23rd July 2020. There are no recommended policy changes to the TMSS or IS. The details in this report update the position in the light of the updated economic position and budgets already approved. However a revised Treasury Strategy will be presented to Cabinet for recommendation to Council in December, in relation to new investment options and opportunities.

4. Investments Review

4.1 The Council has an investment portfolio consisting of reserves and cash arising from daily receipts being in excess of payments on a short-term basis.

4.2 As directed by the Treasury Management Strategy, security and liquidity has been prioritised above the requirement to maximise returns. A cautious approach is taken to lending to financial institutions, and credit quality information regarding the institutions on the Council's approved Lending List is monitored.

4.3 The Council's investment portfolio at 30 September 2020 was as follows:

Table 1: Investment Position at 30 September 2020

	1st April 2020	Additions (Withdrawals)	30th September 2020
In house deposits	222.012	14.939	135.216
Money Market/External Funds	131.189	4.027	236.951
Total Treasury Management Investments	**353.201**	**18.966**	**372.167**
Cash	21.044	6.681	27.725
Total Cash and Cash Equivalents and Short Term Investment	**374.245**	**25.647**	**399.892**

4.4 Balances at the end of September are higher with the following factors having impacted on cash balances:

- An underspend on the 2020/21 capital programme including some slippage to future years.
- A forecast revenue underspend for 2020/21.
- The repayment of £10m of Public Works Loan Board debt in the first half of the year.
- Receipt of Covid related government grant early in the year.
- Changes made to payment terms for suppliers to support their cashflow during the Covid crisis.

4.5 In 2019/20 there had been a planned shift of emphasis away from short term investments to longer term investments with higher returns. However, in the first half of 2020/21 there has been a significant shift from longer-term in-house deposits to shorter term externally manged funds as shown in Table 1. This reflects a change in focus towards maintaining increased liquidity to provide more flexibility and ability to respond to unexpected circumstances driven by the Covid pandemic, which was a new and uncertain situation.

4.6 Appendix A illustrates the deposits making up the £372.167m of assets held at 30 September. Investments with counterparties were kept within approved counterparty limits during the period from April to September 2020.

4.7 The performance of the Council's internally and external managed investments (weighted) versus the benchmark is set out in Table 2.

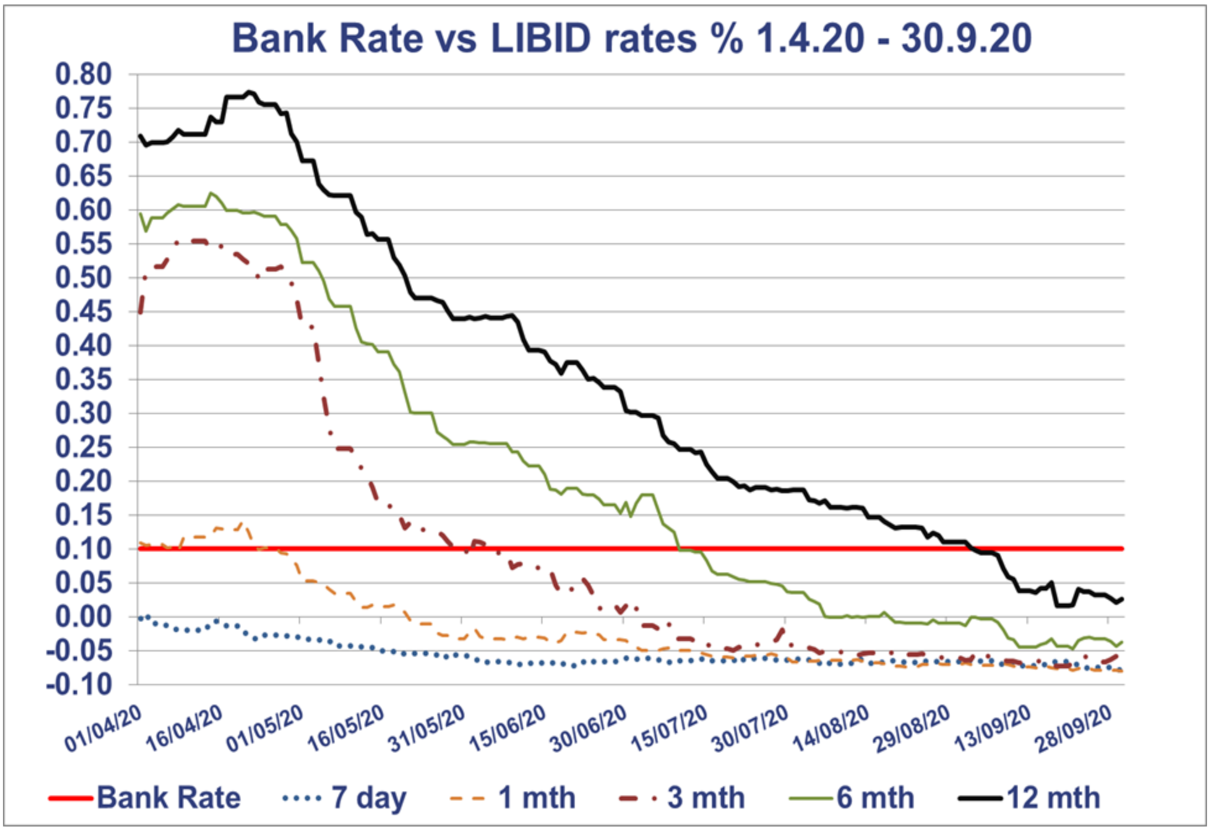
Table 2: Investment Performance to 30 September 2020

%	Average Interest rate year to date	Target rate : 30 day LIBID + 0.46%	Variance
In house deposits	0.77	0.44	0.33
Money Market/External Funds	0.72	0.44	0.28
Weighted Average	**0.74**	**0.44**	0.30

4.8 The benchmark was revised for 2020/21 to reflect 30 day London Inter Bank Bid Rate (LIBID) plus 0.46% whereas previously the target was 7 day LIBID. The updated target reflects that funds can be invested for longer than 7 days and that treasury returns had been exceeding LIBID previously. However, the impact of Covid is such that the average 30 day LIBID rate is negative for the first half of 2020/21 (-0.02%) and therefore the target rate is 0.44%

4.9 The investment environment in the first half of 2020/21 was dominated by the impact of the Covid pandemic. Economic activity was severely curtailed and the Bank of England base rate, already at a low of 0.75%, was reduced to 0.25% on the 11th March and then to 0.1% on the 19th March. Inter-bank lending rates reduced over the first half of the year.

Chart 1 – Bank of England Base Rate and Inter Bank Rates



4.10 The impact on rates of return on treasury investments varied with each type of investment, but overall investment returns have fallen more slowly than the underlying rates illustrated in Chart 1.

- Fixed term fixed rate loans to other institutions (mostly other Local Authorities) continued to pay at the agreed interest rates until the loans matured. Then as replacement loans have been issued the rates attained on those have gradually reduced.

- Money market fund returns have gradually reduced, following the base rate reduction with a lag of the order of many months in duration.

- The CCLA Property Fund and Threadneedle Social Bond Fund have continued to pay income at similar levels to the start of the year. However the property fund suspended trading (as did a number of property funds) in order to protect investors from excessive withdrawals putting the fund and the majority of its clients at risk by being forced to sell assets at distressed prices. The suspension did not impact on Warwickshire County Council as our investment in the fund is intentionally a small proportion of total cash, and is invested over a long time horizon rather than being expected to provide liquidity.

4.11 The overall mix of investments has changed to become more liquid at the expense of returns. However, now that some of the initial uncertainties of the impact of Covid have reduced, the focus will change back to looking for longer dated investments with higher returns to the extent that the Council's liquidity requirements allow it. For example in respect of Local Authority loan activity which has been reducing, the treasury service has made arrangements to have access to more deal brokers (3, when previously there was 1), and the current intention is to seek approval in the next TMSS to be able to make loan agreements in advance with other Local Authorities as this will open up significantly more opportunities compared to only agreeing to loans on the same day they are issued.

4.12 Appendix B illustrates the mix of treasury management investment returns from the different deposits held at the end of September. Returns vary significantly however risk also varies with return. This analysis excludes cash balances which are not investments and investments that are not held for treasury management purposes. Because interest rates have been falling significantly, for many investments the actual rate of return as at the end of September is significantly lower than the average rate of return for the first half of the year.

4.13 The interest earned on the Council's investments has exceeded the benchmark, because the benchmark has reduced over time reflecting the economic situation. However, the budget for treasury investment returns (£3.4m net) was set before the impact of the pandemic was realised and the forecast returns currently anticipate a shortfall of approximately £1.7m against this target. The shortfall for 2020/21 will be funded from the interest rate volatility reserve, which specifically protects against interest rate fluctuations over time. Interest earned to date is summarised in the table below:

Table 3: Interest Earned to September 2020

£m	Gross	*Estimated Costs	Net
In house deposits	0.615	n/a	0.615
Money Market/External Funds	0.813	0.193	0.620
Total	**1.428**	**0.193**	**1.235**

- Costs are mid-year estimates – actual costs will be updated at the outturn.

4.14 Externally managed funds incur management fees which are noted in Table 3. Internally managed funds do not present fees in the same way, either county council cash is lent to other institutions (e.g. other local authorities) who pay fees as the borrower, or are invested in deposit funds that present net returns rather than gross returns with costs.

4.15 Most of the deposits simply provide a return and the deposit value is static. However, some funds are of a nature where the deposit itself has a value which can rise or fall. The changes in the underlying asset value of these investments are not reflected in investment returns above but would be realised upon selling. This issue relates to the CCLA Property Fund and the Threadneedle Social Bond Fund whose values are illustrated in Appendix C. The value of both of these funds has been impacted by Covid but both are held for returns over significantly longer durations than most treasury investments and are not required for liquidity purposes at this time.

4.16 Further information about funds held is summarised in Appendix D. This information focuses on treasury management investment returns and so excludes cash balances which are not investments, and long term investments which are not held for treasury management purposes.

4.17 Table 4 details our consultant's view on interest rates. With continued uncertainty, for example over the final terms of Brexit and the impact of Covid, the base rate and money market rates are likely to remain at low levels. Further commentary on the wider economic environment and interest rate forecasts from our external advisers (Link) is provided at Appendix E.

Table 4: Interest Rate Forecast

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

Source: Link Asset Services 11th August 2020

Negative Investment Rates

4.18 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

4.19 In respect of money market funds (MMFs), yields have continued to drift lower. Some fund managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money at the very short end of the market. This has seen a number of market operators, now including the government's Debt Management Account Deposit Facility, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions. However when the bank rate goes down there is a degree of lag before the impact affects the returns from MMFs.

4.20 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Creditworthiness

4.21 Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30th June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions.

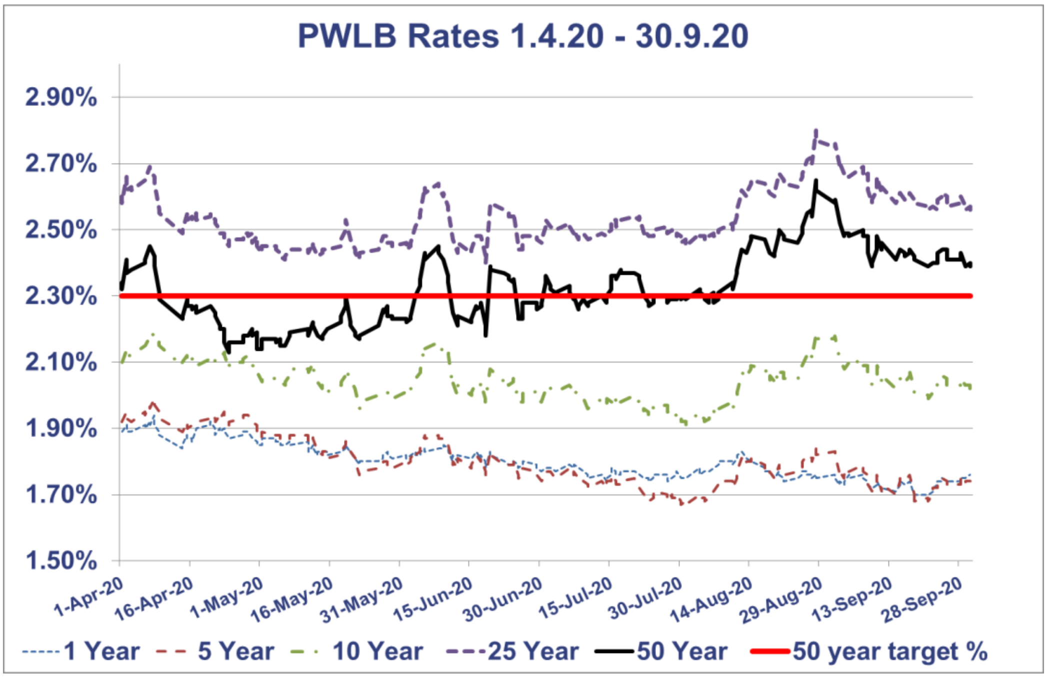
4.22 As we move into the quarters ahead, more information will emerge on *actual* levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They stated 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%. All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

5 Borrowing Strategy and Debt Financing

5.1 As at the end of September 2020 the authority has borrowing held with the Public Works Loans Board (PWLB) of £332m. This is after accounting for the repayment of £10m of principal in September. The weighted average interest payable on the loans during the year to date has been 4.9%. Total interest payable during the year to date is £8.378m. All debt is fixed rate and fixed maturity.

5.2 The Council did not undertake any new long-term borrowing during the first half of the year. The Council is currently in an over-borrowed position and does not anticipate taking out any new external borrowing in the remainder of 2020/21 based on the current capital financing requirement. However, the recent trends on PWLB borrowing rates are reproduced for information in the chart below.

Chart 2 – Trends in Available Borrowing Rates



5.3 Borrowing has remained within the defined prudential limits. The profile of when £332m of remaining debt is due to mature is set out in Appendix F.

5.4 No debt rescheduling (paying off more existing debt and replacing it with new debt) has been undertaken as PWLB loan repayments are subject to penalties for early redemption that make early repayments uneconomic.

5.5 No changes to the borrowing strategy are recommended.

6 Compliance with Treasury Limits and Prudential Indicators

6.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the first half year ended 30th September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020.

6.2 Details of capital spending and Prudential Indicators are shown in Appendix G. Explanations of the terminology employed are set out in Appendix H**.**

6.2 A detailed report on capital spending is set out elsewhere on this Cabinet agenda.

7 Sensitivity Analysis

7.1 For the purposes of disclosure on Market Risk a sensitivity analysis has been carried out to show the impact of a change in interest rates of + 1% on the debt portfolio.

7.2 The following table shows the results of the sensitivity analysis:

Table 5 Interest Rate Sensitivity Analysis

	Actual	+1% increase in Base Rate	
	Fair Value at 31.03.2020 £m	Fair Value at 31.03.2020 £m	Difference £m
Debt (new borrowing)	507.529	427.613	-79.916
Debt (early repayment)	738.175	603.420	-134.755

7.3 The above table demonstrates how as interest rates rise the fair value of a given level of debt reduces, i.e. less cash would be required now in order to meet a given future series of cashflows if interest rates rise.

7.4 New borrowing illustrates the fair value of debt if taken out at a certain point in time. Early repayment illustrates the additional premium payable on the portfolio of loans to compensate for loss of interest for the Treasury.

8.0 Non-Treasury Management Investments

8.1 The Council also receives income from longer term investments that are held for service reasons rather than treasury management purposes, including for example the University of Warwick Science Park and Educaterers Ltd. These long-term investments are valued at £2m. On a cash basis dividend income of £11k has been received in the first half of the year.

8.2 The Council has a loan facility with Educaterers Ltd, a wholly owned company. For the first half of the year interest earned was £31k.

8.3 The Council is developing plans relating to potential non-treasury investments over the longer term however any new investment or borrowing in respect of this will require full Council approval of an appropriately revised Treasury Management Strategy Statement and Investment Strategy.

9.0 Financial Implications

9.1 The financial implications of the Treasury Management outturn are set out in the body of the report.

10.0 Environmental Implications

10.1 None.

11.0 Supporting Information

11.1 Supporting information is set out in the body of the report and appendices.

12.0 Timescales Associated With Next Steps

12.1 A Treasury Management outturn report will be presented to Cabinet after the year end.

Appendices

Appendix A – Investment Balances as at 30/9/2020
Appendix B – Investment % Returns as at 30/9/2020
Appendix C – Asset Value Movements
Appendix D – Cash Funds Summary
Appendix E – Economics and Interest Rates Update
Appendix F – PWLB Maturity Profile
Appendix G – Prudential Indicators
Appendix H – Prudential Indicators Glossary

Background Papers

None

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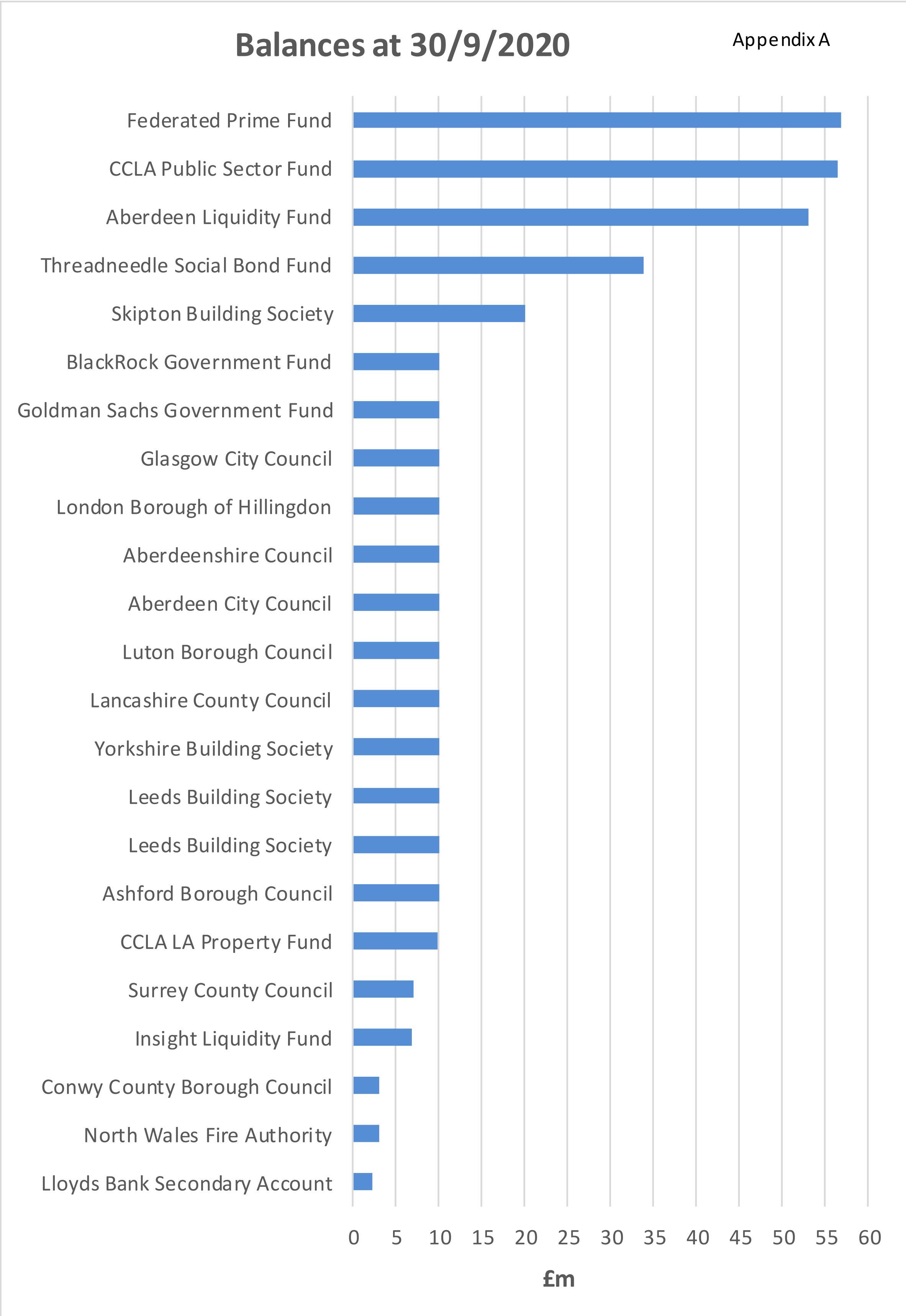
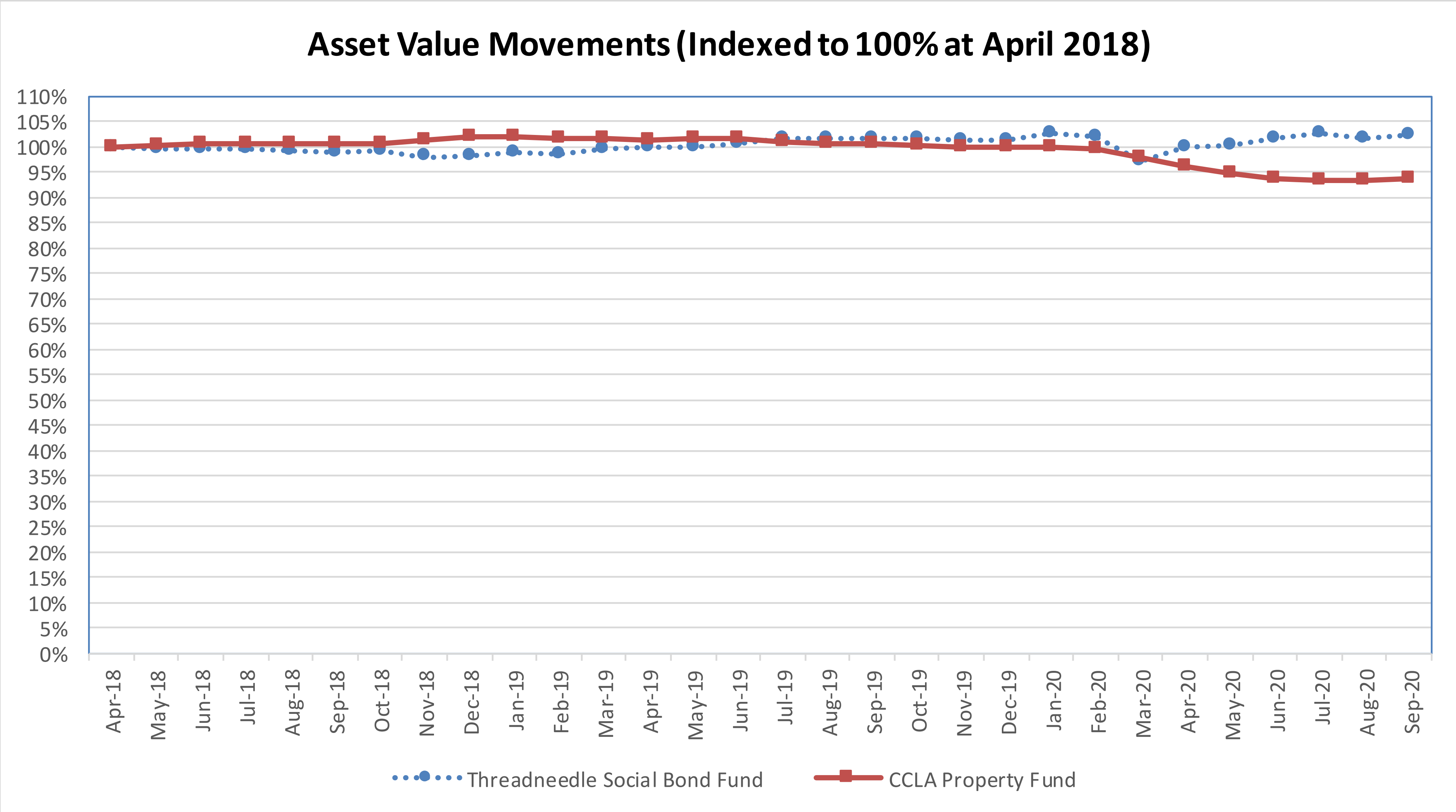
The report was circulated to the following members prior to publication:
Local Member(s):
Other members:


Balances at 30/9/2020
Appendix A
Federated Prime Fund
CCLA Public Sector Fund
Aberdeen Liquidity Fund
Threadneedle Social Bond Fund
Skipton Building Society
BlackRock Government Fund
Goldman Sachs Government Fund
Glasgow City Council
London Borough of Hillingdon
Aberdeenshire Council
Aberdeen City Council
Luton Borough Council
Lancashire County Council
Yorkshire Building Society
Leeds Building Society
Leeds Building Society
Ashford Borough Council
CCLA LA Property Fund
Surrey County Council
Insight Liquidity Fund
Conwy County Borough Council
North Wales Fire Authority
Lloyds Bank Secondary Account
0
5
10
15
20
25
30
35
40
45
50
55
60
£m


% Returns at 30/9/2020
Appendix B
CCLA LA Property Fund
Threadneedle Social Bond Fund
Conwy County Borough Council
North Wales Fire Authority
Surrey County Council
London Borough of Hillingdon
Luton Borough Council
Lancashire County Council
Leeds Building Society
Aberdeen City Council
Leeds Building Society
Aberdeenshire Council
Yorkshire Building Society
Glasgow City Council
Ashford Borough Council
CCLA Public Sector Fund
Skipton Building Society
Aberdeen Liquidity Fund
Federated Prime Fund
Insight Liquidity Fund
Goldman Sachs Government Fund
BlackRock Government Fund
Lloyds Bank Secondary Account
0.00%
1.00%
2.00%
3.00%
4.00%
5.00%
%

Appendix C


Asset Value Movements (Indexed to 100% at April 2018)
110%
105%
100%
95%
90%
85%
80%
75%
70%
65%
60%
55%
50%
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
Apr-18
May-18
Jun-18
Jul-18
Aug-18
Sep-18
Oct-18
Nov-18
Dec-18
Jan-19
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Apr-20
May-20
Jun-20
Jul-20
Aug-20
Sep-20
Threadneedle Social Bond Fund
CCLA Property Fund

Cash Funds Summary

Appendix D

Internally Managed Funds	£m	Net % Rate at 30/9/2020	Duration (from inception)	Duration (from end of September 2020)	Fitch Long Term Credit Rating
Surrey County Council	7.0	0.70%	183	28	AA-
North Wales Fire Authority	3.0	0.75%	183	28	AA-
Conwy County Borough Council	3.0	0.75%	183	28	AA-
Skipton Building Society	20.0	0.13%	122	82	A-
Ashford Borough Council	10.0	0.15%	184	128	AA-
Leeds Building Society	10.0	0.27%	184	128	A-
Leeds Building Society	10.0	0.25%	184	135	A-
Yorkshire Building Society	10.0	0.16%	185	145	A-
Lancashire County Council	10.0	0.40%	288	197	AA-
Luton Borough Council	10.0	0.40%	318	212	AA-
Aberdeen City Council	10.0	0.25%	273	217	AA-
Aberdeenshire Council	10.0	0.22%	273	230	AA-
London Borough of Hillingdon	10.0	0.50%	364	251	AA-
Glasgow City Council	10.0	0.15%	273	257	AA-
Lloyds Bank Secondary Account	2.2	0.00%	same day	same day	A+
Total	**135.2**				

Externally Managed Funds	£m	Net % Rate at 30/9/2020	Duration (from inception)	Duration (from end of September 2020)	Fitch Long Term Credit Rating
Aberdeen Liquidity Fund	53.1	0.09%	same day	same day	AAA
CCLA Public Sector Fund	56.5	0.14%	same day	same day	AAA
BlackRock Government Fund	10.0	0.00%	same day	same day	AAA
Federated Prime Fund	56.9	0.06%	same day	same day	AAA
Goldman Sachs Government Fund	10.0	0.00%	same day	same day	AAA
Insight Liquidity Fund	6.8	0.02%	same day	same day	AAA
CCLA LA Property Fund (trading suspended) *estimated return	9.9	4.26%	30	30	
Threadneedle Social Bond Fund *estimated return	33.8	2.30%	4	4	
Total	**237.0**				

Appendix E

Economics and Interest Rates – Link Update

Economics Update

E1 As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in **GDP** 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 peak in the **unemployment rate** was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI **inflation** to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

E2 It also squashed any idea of using **negative interest rates**, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.

E3 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 further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

E4 In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to **downside risks,** which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including Britain, to see the dangers. However, rather than a national lockdown, as in March, any spikes in virus infections are now likely to be dealt with by localised measures and this should limit the amount of economic damage caused. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery. The wind down of the initial generous furlough scheme through to the end of October is another development that could cause the Bank to review the need for more support for the economy later in the year. Admittedly, the Chancellor announced in late September a second six month package from 1st November of government support for jobs whereby it will pay up to 22% of the costs of retaining an employee working a minimum of one third of their normal hours. There was further help for the self-employed, freelancers and the hospitality industry. However, this is a much less generous scheme than the furlough package and will inevitably mean there will be further job losses from the 11% of the workforce still on furlough in mid September.

E5 Overall, **the pace of recovery** is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

E6 There will be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

E7 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 any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

E8 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%.

E9 **US.** The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by continuing outbreaks of the virus in some states leading to fresh localised restrictions. At its end of August meeting, the Fed tweaked **its inflation target** from 2% to maintaining an average of 2% over an unspecified time period i.e. following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary “trap” like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC’s updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

E10 **EU.** The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting some countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

E11 **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

E12 **Japan.** There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.

E13 **World growth.** Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Interest Rate Forecasts

E14 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September meeting), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

E15 **GILT YIELDS / PWLB RATES**. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

E16 Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. At the close of the day on 30th September, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

E17 From the local authority borrowing perspective, HM Treasury imposed **two changes of margins over gilt yields for PWLB rates** in 2019-20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June, but that date was subsequently put back to 31st July. It is clear HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

E18 Following the changes on 11th March 2020 in margins over gilt yields, 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)

E19 It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

E20 As the interest forecast table for PWLB certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

The balance of risks to the UK

E21 The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.

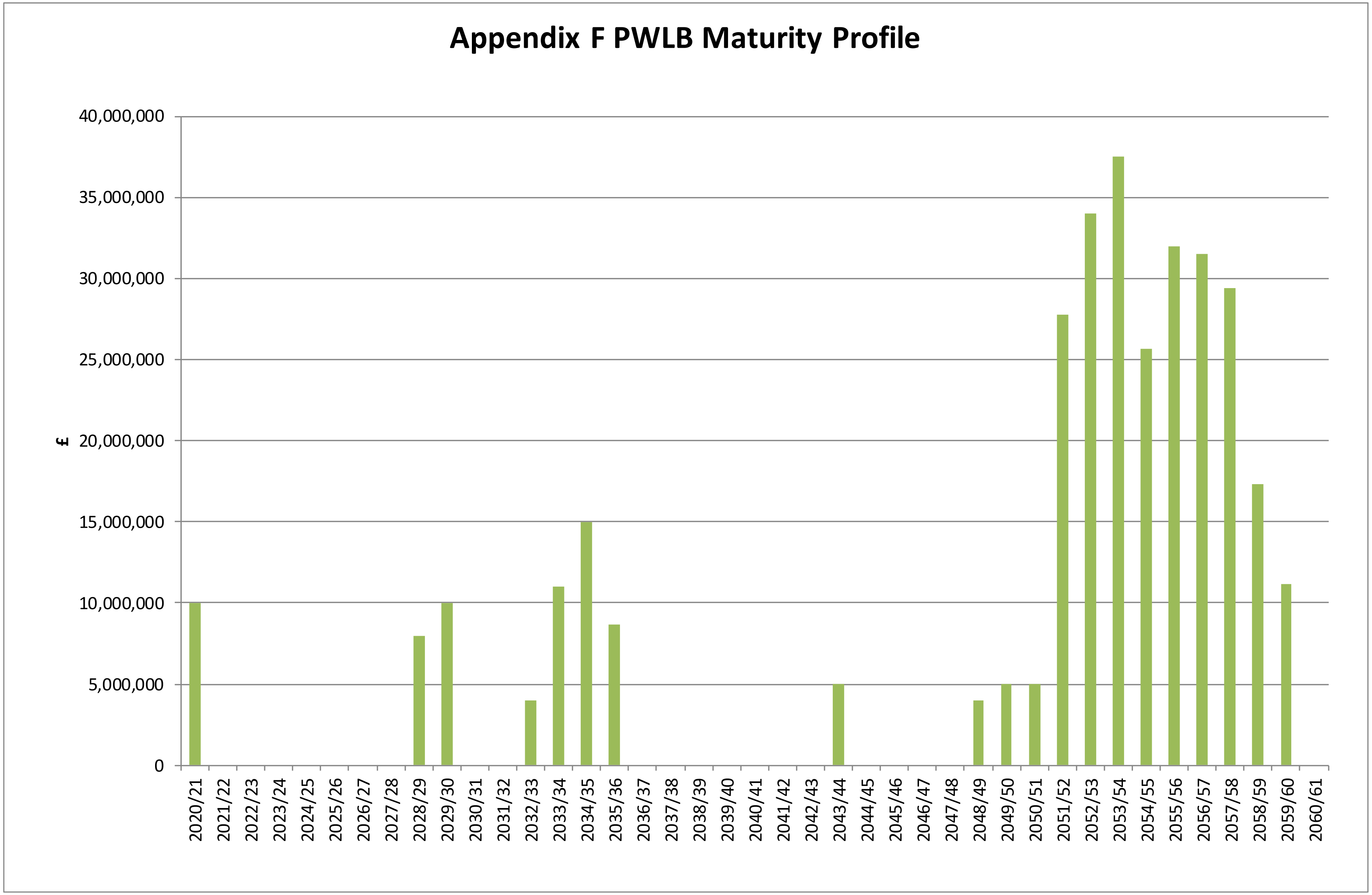
E22 There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

E23 **Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- **UK -** second nationwide wave of virus infections requiring a national lockdown
- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- **US – the Presidential election in 2020:** this could have repercussions for the US economy and SINO-US trade relations.

E24 **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **UK -** stronger than currently expected recovery in UK economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.



Appendix F PWLB Maturity Profile
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Prudential Indicators — Appendix G

(1). AFFORDABILITY PRUDENTIAL INDICATORS	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
	£'000	**£'000**	**£'000**
Capital Expenditure	169,484	196,402	117,548
	%	**%**	**%**
Ratio of financing costs to net revenue stream	6.71	7.00	7.61
Gross borrowing requirement	**£'000**	**£'000**	**£'000**
Gross Debt	332,274	332,275	332,275
Capital Financing Requirement as at 31 March	304,496	363,384	408,571
Under/(Over) Borrowing	(27,778)	31,109	76,297
	£'000	**£'000**	**£'000**
In year Capital Financing Requirement	14,787	58,888	45,187

PRUDENTIAL INDICATOR	2020/21	2021/22	2022/23
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS			
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**
Borrowing	515,485	543,623	560,620
other long term liabilities	12,000	12,000	12,000
TOTAL	**527,485**	**555,623**	**572,620**
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**
Borrowing	429,570	453,019	467,183
other long term liabilities	10,000	10,000	10,000
TOTAL	**357,313**	**326,320**	**311,976**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / fixed term investments	100%	100%	100%
Upper limit for variable rate exposure			
Net principal re fixed rate borrowing / fixed term investments	25%	25%	25%
Upper limit for total principal sums invested for over 365 days	**£'000**	**£'000**	**£'000**
(per maturity date)	£60,000	£60,000	£60,000

Maturity structure of borrowing during year	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Appendix H

Prudential Indicators Glossary

Ratio of financing costs to net revenue stream

The ratio of financing costs to net revenue stream shows the estimated annual revenue costs of borrowing, less net interest receivable on investments, plus repayments of capital, as a proportion of annual income from council taxpayers and central government. The estimates of financing costs include current and future commitments based on the capital programme.

Gross Borrowing

Gross borrowing refers to the Authority's total external borrowing and other long term liabilities versus the Capital Financing Requirement.

Actual and Estimated Capital Expenditure

Actual and estimates of capital expenditure for the current and future years.

Capital Financing Requirement

The Capital Financing Requirement (CFR) represents capital expenditure financed by external debt and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR measures the Authority's underlying need to borrow externally for a capital purpose. The Authority has a treasury management strategy which accords with the CIPFA Code of Practice for Treasury Management in the Public Services.

Authorised Limit

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities such as finance leases. Authorised Limits are consistent with the Authority's current commitments, service plans, proposals for capital expenditure and associated financing, cash flow and accord with the approved Treasury Management Policy statement and practices. The Authorised Limit is based on the estimate of most likely prudent, but not necessarily the worst case scenario and provides sufficient additional headroom over and above the Operational Boundary.

Operational Boundary

The Operational Boundary for external debt is based on the same estimates as the authorised limit but reflects the Head of Finance's estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

Limits on Interest Rate Exposure

This means that the Authority will manage fixed and variable interest rate exposure within the ranges. This provides flexibility to take advantage of any favourable movements in interest rates.