ANNEX I - 2020/21 TREASURY MANAGEMENT ANNUAL REPORT

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; presented to Council on 26/02/2020;
b) a mid-year (minimum) treasury update report; delegated decision by Cabinet on 15/12/2020;
c) an annual report following the end of the year describing the activity undertaken compared to the strategy; this report.

1.3. During 2020/21 and in line with best practice principles, the Council also presented quarterly update reports to Cabinet on 01/09/2020 for Q1 & 23/02/2021 for 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

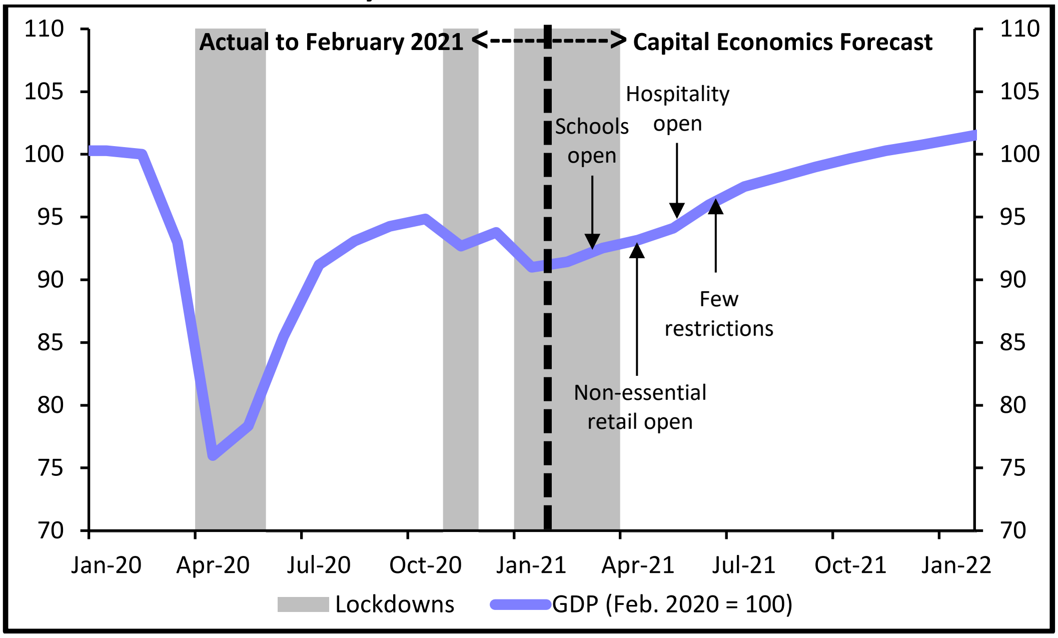
UK Economic background:

2.1. 2020/21 will go down in history as the year of the covid-19 pandemic. The first national lockdown in late March 2020 had a huge impact on the economy, causing an economic downturn that exceeded the financial crisis of 2008/09. A short second lockdown in November had a relatively lesser impact and by the third lockdown in January 2021, businesses and individuals had become far more resilient by adapting to working in new ways. The UK in particular led the world in implementing a fast programme of vaccination in the hope of a return to something approaching normal life during the second half of 2021, which has been instrumental in speeding economic recovery and the reopening of the economy.

2.2. Household saving has been exceptionally high since the first lockdown in March 2020 and so there is plenty purchasing power and pent-up demand stored up for services in still-depressed sectors like restaurants, travel and hotels as soon as they reopen. It is therefore expected that the UK economy could recover to its pre-pandemic level of economic activity during quarter 1 of 2022.

2.3. Chart 1 below shows the relative impact of lockdown measures on UK GDP and the forecast for recovery:

Chart 1: UK GDP Recovery



2.4. Both Government and the Bank of England (BoE) took rapid action in March 2020 at the height of the crisis to provide support to financial markets to ensure their proper functioning, and to support the economy and to protect jobs.

Bank of England:

2.5. The BoE cut Bank Rate from 0.75% to 0.25% and then to 0.10% in March 2020 and embarked on a new £200bn programme of quantitative easing (QE – the purchase of high-security bonds (aka gilts) to increase supply and so reduce yields/borrowing costs). The BoE further increased QE by £100bn in June and by £150bn in November. Along with legacy QE from the financial crisis of 2008/09, QE in total stood at £895bn. While Bank Rate remained unchanged for the rest of the year, financial markets were concerned about the prospect of a negative rate; this was firmly discounted in February 2021 when it was established that commercial banks would be unable to implement negative rates for at least six months – by which time the economy was expected to be making a strong recovery and negative rates would no longer be needed.

2.6. The BoE adopted a major change to implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August 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". This statement is interpreted to mean that even if inflation rises to 2% in a few years' time, we should not expect this to automatically trigger action from BoE to raise Bank Rate until they can clearly see that level of inflation is going to be persistently above target. This sets a high bar for raising Bank Rate and no increase is expected by March 2024 and possibly for as long as five years.

2.7. Inflation has been well under 2% during 2020/21 but is expected to briefly peak at just over 2% towards the end of 2021 for a short time only.

Government support:

2.8. The Chancellor has implemented repeated rounds of support to businesses by way of cheap loans and other measures and has protected jobs by paying for workers to be placed on furlough. This support has come at a huge cost in terms of the Government's budget deficit ballooning in 20/21 and 21/22 so that the Debt to GDP ratio reaches around 100%. The Budget on 3rd March 2021 increased fiscal support to the economy and employment during 2021 and 2022 followed by substantial tax rises in the following three years to help to pay the cost for the pandemic. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from its 100% level.

2.9. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to QE operations substituting fixed long-term debt for floating rate debt. There is, therefore, much incentive for the Government to promote Bank Rate staying low, for example by a) using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and/or b) by amending the Bank's policy mandate to allow for a higher target for inflation.

BREXIT:

2.10. The final agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. The initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas.

Global economies:

2.11. The covid-19 pandemic has reached almost every country in the world. Its spread has left global national economies and businesses counting the costs, as governments wrestle with new lockdown measures to tackle the virus.

2.12. The International Monetary Fund (IMF) estimates that the global economy shrunk by 4.4% in 2020, which it described as the worst decline since the Great Depression of the 1930s. The IMF is, however, predicting global growth of 5.2% in 2021. That will be driven primarily by countries such as India and China, forecast to grow by 8.8% and 8.2% respectively.

2.13. The FTSE, Dow Jones Industrial Average and the Nikkei all saw huge falls as the number of Covid-19 cases grew in the first months of the crisis. The major Asian and US stock markets have recovered following the announcement of the first vaccine in November 2020, but the FTSE still has ground to recover its 14.3% drop in 2020, its worst performance since 2008.

2.14. Further commentary on conditions in major global economies can be found at Appendix 1.

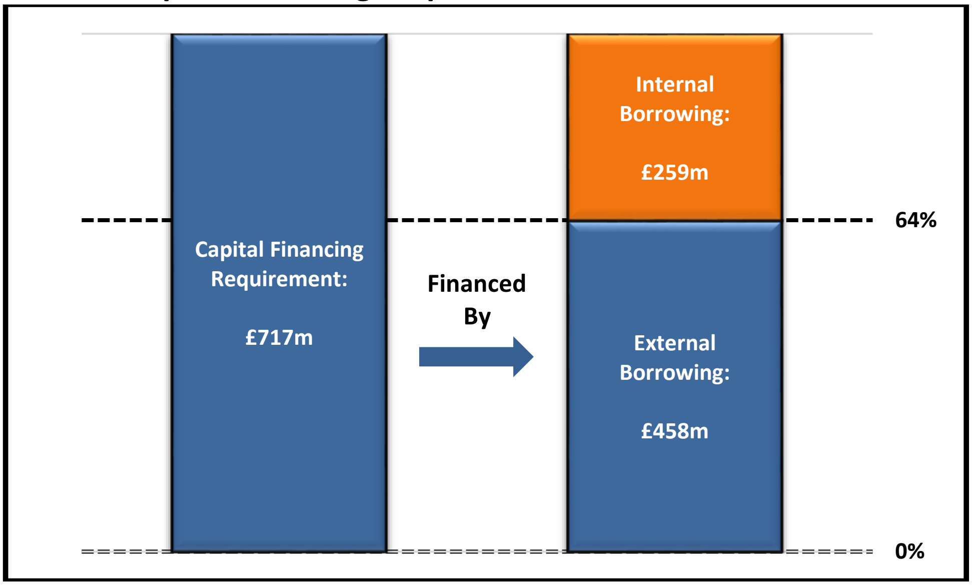
Financial markets:

2.15. Investment returns, already starting from a low base in 2019/20, plunged during 2020/21 to near zero on average and negative at times during the year. The treasury management strategy for 2020/21 was predicated on Bank Rate starting the year at 0.75% before rising to end 2022/23 at 1.25%. This forecast was invalidated by the covid-19 pandemic which caused the BoE to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The BoE and the Government introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year authorities held unexpectedly large amount of cash so there was more liquidity supply in financial markets than there was demand for borrowing, with the consequent effect that investment earnings rates plummeted.

2.16. Regulatory requirements introduced in the aftermath of the 2008/09 financial crisis required financial institutions to set aside increased amount of capital and hold more liquidity. These requirements have provided a far stronger basis for financial institutions to cope even with the severe economic impact of the pandemic. This does not however mean that financial institutions are beyond failure; indeed, with investor bail-in legislation replacing government bail-out, the risk to capital remains prevalent.

2.17. The Council continues to maintain a significant internal borrowing position of c.£259m. This means that the capital borrowing need (Capital Financing Requirement, the CFR) has not been fully funded with external loans. Instead cash supporting the Council's reserves, balances and cash flows is being used as an interim measure. Chart 2 below illustrates the proportion of the CFR by financing means.

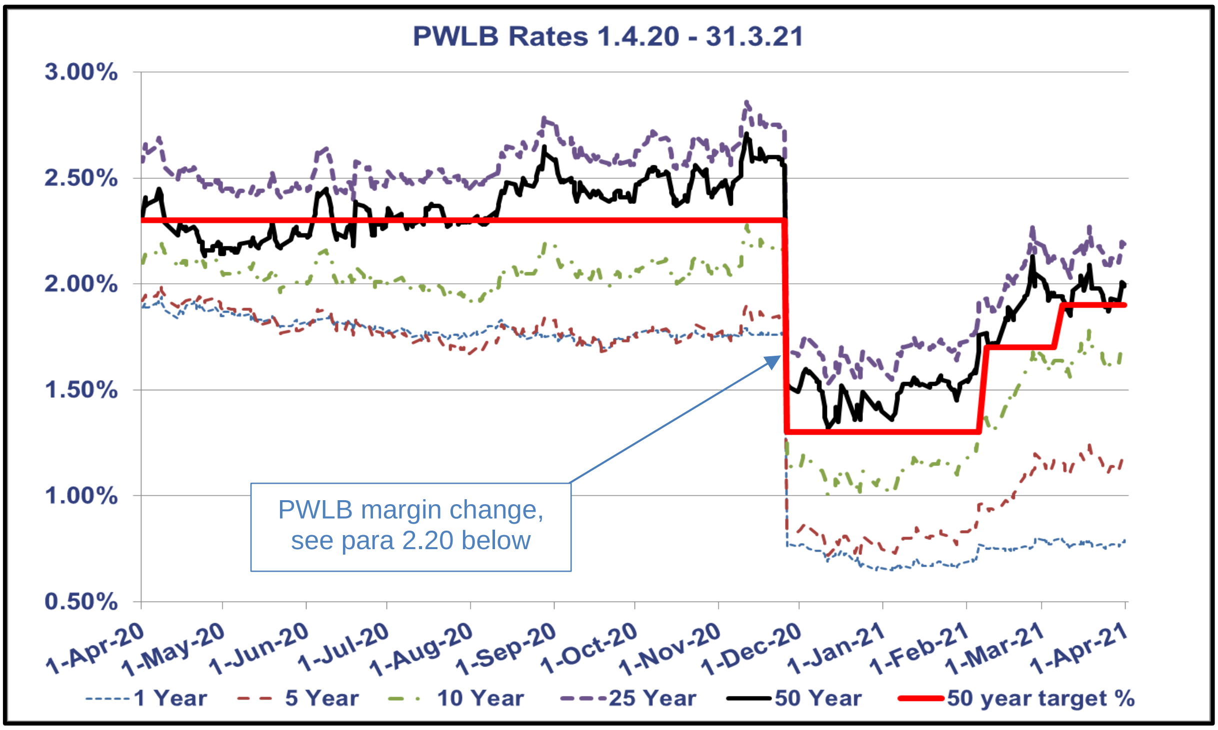
Chart 2: Capital Financing Requirement external vs internal borrowing



2.18. The strategy of avoiding new borrowing by utilising cash balances remains the most cost-effective approach at this time, but is kept under review so not to incur higher borrowing costs in the future when it may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

2.19. The primary and most simplistic borrowing source for local authorities continues to be the PWLB, whose rates are based on gilt (UK Government bonds) yields. Chart 3 below illustrates PWLB rate movements during the year.

Chart 3: PWLB Rates during 2020/21



2.20. Gilt yields fell sharply from the start of 2020 and then spiked up during a financial markets downturn in March caused by the pandemic hitting western countries; this was rapidly countered by central banks flooding the markets with liquidity. While US treasury yields do exert influence on UK gilt yields so that the two often move in tandem, they have diverged during the first three quarters of 2020/21 but then converged in the final quarter. Expectations of economic recovery started earlier in the US than the UK but once the UK vaccination programme started making rapid progress in the new year of 2021, gilt yields and so PWLB rates started rising as confidence in economic recovery rebounded, again albeit from a low starting point.

2.21. HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without warning. The first took place in October 2019 adding an additional 1% margin across the board. That increase was then, at least partially, reversed for some forms of borrowing in March 2020, but not for mainstream non-HRA capital schemes. A consultation was then held with local authorities and in November 2020 the Chancellor announced that standard and certainty margins were reduced by 1%, but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets solely for yield in its three year capital programme. The new margins over gilt yields are:

- PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
- PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
- 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)

2.22. There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise in the near term.

3. Annual Investment Strategy

3.1. 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 then
3. **Y**ield

3.2. Interest rates expectations within the 2020/21 strategy anticipated low but rising Bank Rate, with gradual rises in medium and longer term fixed borrowing rates. Continued market risks promoted a cautious approach to investments, whereby options would continue to be dominated by a low counterparty risk appetite, resulting in relatively low returns (when compared to borrowing rates) in achieving low risk. Notwithstanding the Councils strategic approach to avoid new borrowing, short-term borrowing rates were expected to be the cheapest form of borrowing should the situation have changed and funds needed to be raised.

4. Borrowing

4.1. 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.

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

Table 1: Borrowing profile at 31st March 2021 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%	£9,732,747.07	2.2%	£14,732,747.07	3.2%
1 - 2 Years	£0.00	0.0%	£10,096,560.77	2.3%	£10,096,560.77	2.2%
2 - 5 Years	£0.00	0.0%	£43,516,823.75	9.8%	£43,516,823.75	9.5%
5 - 10 Years	£0.00	0.0%	£59,910,517.91	13.5%	£59,910,517.91	13.1%
10 - 20 Years	£0.00	0.0%	£149,754,921.58	33.8%	£149,754,921.58	32.6%
20 - 30 Years	£0.00	0.0%	£20,000,000.00	4.5%	£20,000,000.00	4.4%

Tenor Bucket	Market Loans		PWLB Loans		Total	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
30 - 40 Years	£0.00	0.0%	£116,000,000.00	26.2%	£116,000,000.00	25.3%
40 - 50 Years	£10,000,000.00	66.7%	£34,360,000.00	7.7%	£44,360,000.00	9.7%
> 50 Years	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
Total	**£15,000,000.00**	**100.0%**	**£443,371,571.08**	**100.0%**	**£458,371,571.08**	**100.0%**

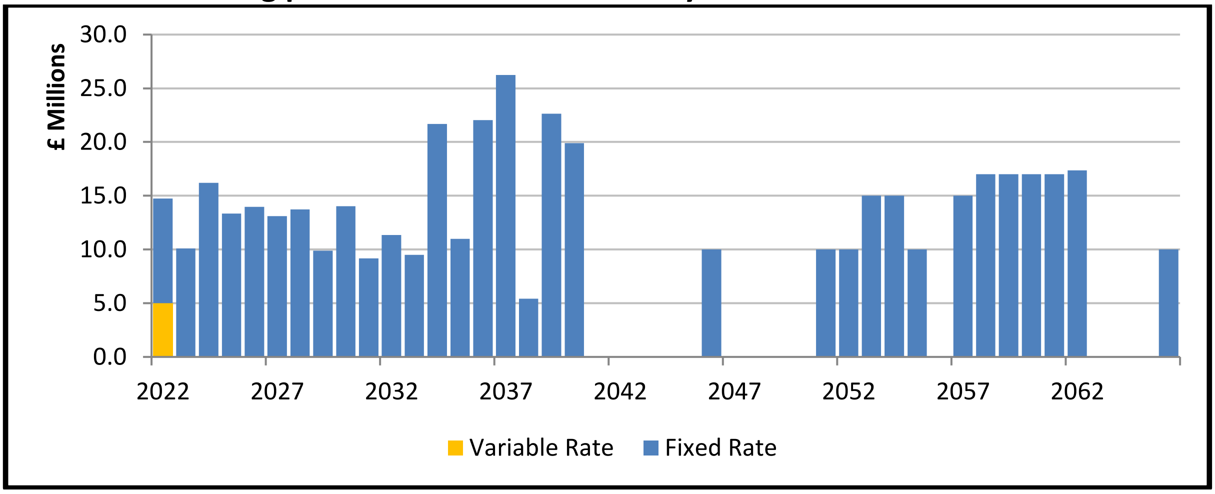
4.3. Tables 2 below sets out the profile of the Council's borrowing portfolio by interest rate structure/exposure:

Table 2: Borrowing profile at 31st March 2021 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	£9,732,747.07	2.2%	£5,000,000.00	100.0%	£14,732,747.07	3.2%
1 - 2 Years	£10,096,560.77	2.2%	£0.00	0.0%	£10,096,560.77	2.2%
2 - 5 Years	£43,516,823.75	9.6%	£0.00	0.0%	£43,516,823.75	9.5%
5 - 10 Years	£59,910,517.91	13.2%	£0.00	0.0%	£59,910,517.91	13.1%
10 - 20 Years	£149,754,921.58	33.0%	£0.00	0.0%	£149,754,921.58	32.6%
20 - 30 Years	£20,000,000.00	4.4%	£0.00	0.0%	£20,000,000.00	4.4%
30 - 40 Years	£116,000,000.00	25.6%	£0.00	0.0%	£116,000,000.00	25.3%
40 - 50 Years	£44,360,000.00	9.8%	£0.00	0.0%	£44,360,000.00	9.7%
> 50 Years	£0.00	0.0%	£0.00	0.0%	£0.00	0.0%
Total	**£453,371,571.08**	**100.0%**	**£5,000,000.00**	**100.0%**	**£458,371,571.08**	**100.0%**

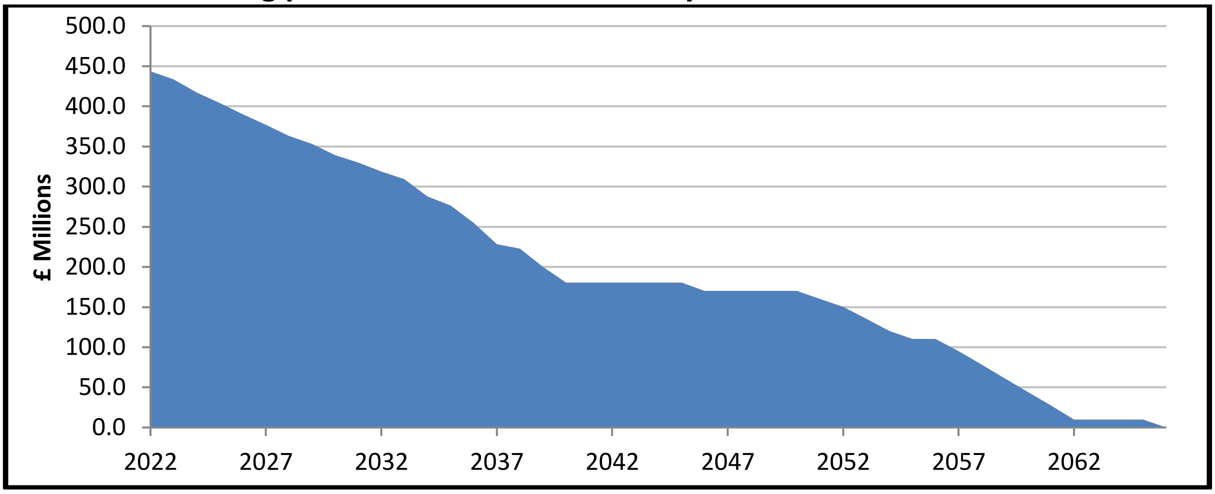
4.4. Chart 4 below shows the annual maturity profile of the Council's borrowing portfolio:

Chart 4: Borrowing profile at 31st March 2021 by annual maturities



4.5. Chart 5 below shows the fallout structure of the Council's borrowing portfolio:

Chart 5: Borrowing profile at 31st March 2021 by cumulative annual maturities



4.6. No new borrowing was undertaken during 2020/21. PWLB loan principal totalling £7.027m was repaid in line with loan agreements. The average rate across the Council's borrowing portfolio at 31st March 2021 was 4.34% (from 4.35% on 31st March 2020).

4.7. 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 2020/21 and is not expected to do so in the near future, so officers are considering this loan to be long term funding.

5. Debt Restructuring

5.1. No debt rescheduling was undertaken during the year. 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.

6. HRA Debt Pooling arrangements

6.1. 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 Housing Revenue Account (HRA) at a consolidated rate in proportion to the debt held by each. This approach was applied during 2020/21.

6.2. Whilst HRA and GF borrowing levels are broadly in line a single pool is a reasonable approach. However in October 2018 the government removed the imposed debt caps which restricted how much housing authorities could borrow against their HRA. This freed up significant additional borrowing capacity in 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. Ambitious planned investment in the HRA would distort the current debt balance.

6.3. In September 2020 Cabinet approved that the current single debt pool for GF and HRA debt would be replaced with two separate debt pools from 1st April 2021. Current borrowing rates are significantly below that of historic debt and moving to a two-pool arrangement will enable the HRA to benefit in full from the lower borrowing rate (for new borrowing) and not share the impact of lowering its debt average cost with the GF.

6.4. The Council sought to establish clear metrics for assessing HRA debt and has chosen to implement an Interest Cover Ratio (ICR). The ICR metric is based on the total interest payable from revenue operating surpluses (income less management & maintenance costs and depreciation) after applying a multiplier of 1.25, which effectively provides a 25% contingency against reductions in operating surpluses. Borrowing limits are set for a five-year period (consistent with the Medium Term Financial Plan) but reviewed in full annually alongside the HRA Business Plan to take account of changes in the external environment, legislation, and approved capital and revenue expenditure and income. The model will be updated in-year as new capital schemes are approved together with an annual refresh of the core assumptions.

6.5. By adopting borrowing limits based on interest cover, the level of affordable borrowing will change as new investment decisions are made reflecting both the capital costs (new debt) and the revenue consequences of new investments on the Operating Surplus. All new schemes will therefore need to be assessed individually and in the overall context of best use of limited borrowing capacity and value for money.

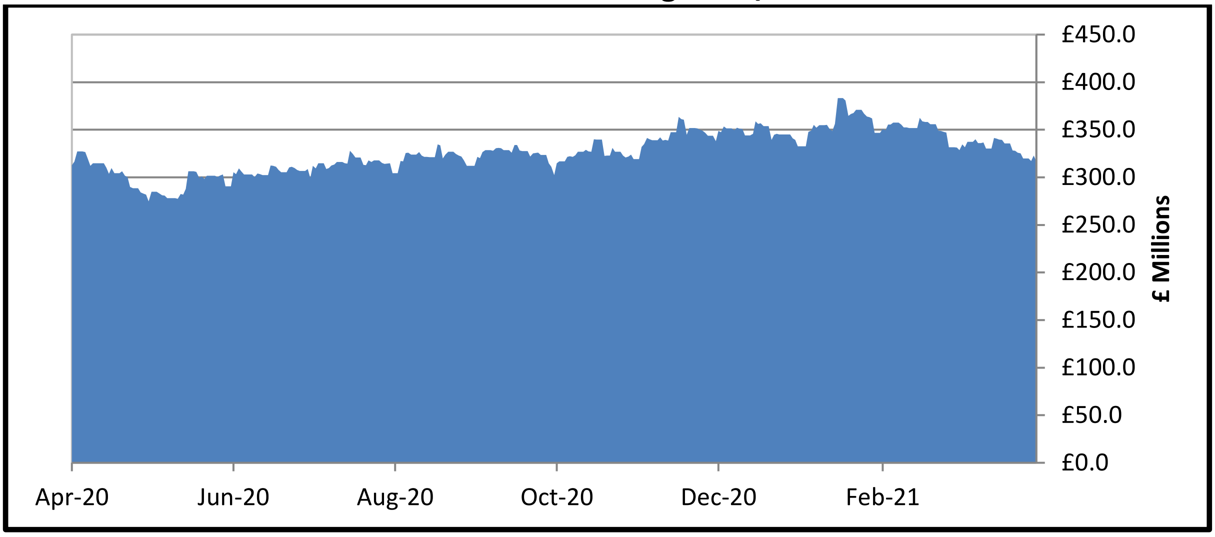
7. Investments

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

7.2. 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.

7.3. During 2020/21 the Council's investment balances ranged from a low of £274.7m to a high of £383.3m due to timing differences between income and expenditure. The average balance held was £326.9m. Chart 6 below plots the 2020/21 annual cycle of fluctuation in investment balances:

Chart 6: Total Investment balances held during 2020/21



7.4. Table 3 below shows the Council's investment maturity position at 31st March 2021:

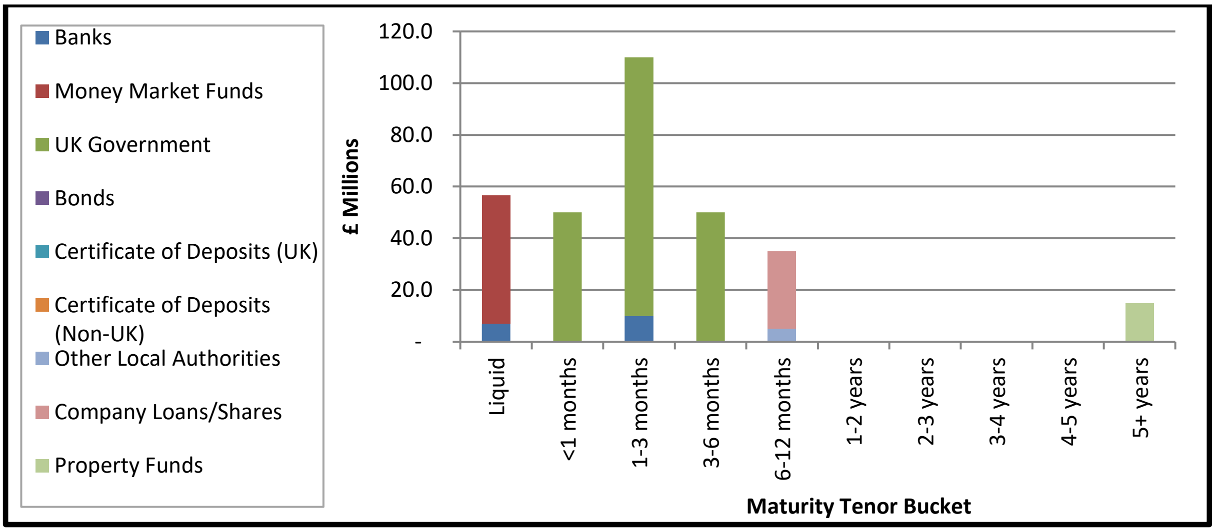
Table 3: Investment Maturity Position at 31st March 2021

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	14,336.19
National Westminster Bank plc	n/a	n/a	0.0100%	Variable	7,019,990.19
Handelsbanken plc	n/a	n/a	0.0000%	Variable	6,507.92
					7,040,834.30
Same-day access: Money Market Funds					
Deutsche	n/a	n/a	0.0050%	Variable	5,110,000.00
Federated	n/a	n/a	0.0100%	Variable	15,000,000.00
Aberdeen	n/a	n/a	0.0100%	Variable	15,000,000.00
Morgan Stanley	n/a	n/a	0.0300%	Variable	14,360,000.00
					49,470,000.00
Notice Accounts: Banks					
Handelsbanken plc – 35d notice	n/a	n/a	0.0100%	Variable	10,000,000.00
					10,000,000.00
UK Government:					
Debt Management Office	08/03/21	08/04/21	0.0100%	Fixed	50,000,000.00
Debt Management Office	04/01/21	04/05/21	0.0100%	Fixed	50,000,000.00
Debt Management Office	04/01/21	04/06/21	0.0100%	Fixed	50,000,000.00
Debt Management Office	04/01/21	02/07/21	0.0100%	Fixed	50,000,000.00

Counterparty	Start Date	Maturity Date	Interest Rate	Interest Rate Structure	Principal O/S (£)
					200,000,000.00
Other Local Authorities:					
Cheshire West and Chester Council	31/03/20	31/03/22	1.8000%	Fixed	5,000,000.00
					5,000,000.00
Company Loans/Shares:					
Milton Keynes Development Partnership LLP	11/11/20	11/11/21	2.6300%	Fixed	30,000,000.00
					30,000,000.00
Property Funds (variable net asset value [VNAV]):					
CCLA Local Authorities Property Fund	30/03/15	n/a	4.4508%	Variable	4,724,994.13
CCLA Local Authorities Property Fund	26/02/16	n/a	4.4508%	Variable	10,048,937.66
					14,773,931.79
					316,284,766.09

7.5. Chart 7 below shows the investment portfolio maturity profile by tenor buckets per category type at 31st March 2021:

Chart 7: Investment profile at 31st March 2021 by maturity category & tenor buckets



7.6. Investment balances bought forward at 31st March 2020 were £278.196m. Due to the front-loaded nature of various government funding streams, the average level of funds available for investment purposes during the year was £326.900m (£294.366m for 2019/20). As shown in Table 3 above, actual balances at 31st March 2021 were £316.285m, primarily due to government support related to the covid-19 pandemic and delays & rephrasing of the capital programme.

Externally managed strategic funds:

7.7. The Council has invested a total 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. This investment generated a £0.652m net income return towards supporting public services.

7.8. At 31st March 2020, the fair value of the Council's holdings was £14.880m. At 31st March 2021, the fair value of the Council's holdings had decreased to £14.774m, representing a £0.106m reduction in holding value. Excluding accrued interest of £0.164m, the fair value at 31st March 2021 is £0.226m lower than the Councils initial £15.0m cash investments, which represents an unrealised loss. The Council has no plans to liquidate this investment.

7.9. CCLA issued a notice on 25th March 2020 to suspend purchase and redemption transactions in direct response to the pervasive effects of covid-19. The temporary suspension had no impact on the Council and we continued to receive regular dividend returns.

7.10. 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.

7.11. The dealing suspension ended in September 2020, but the fund has since introduced a notice period of 90 days. The purpose of the redemption notice period is to align the dealing terms of the funds with the liquidity of their underlying assets and ensure the resilience of the funds during periods of market stress. This change in terms has no significant impact upon the Council which has always been treated as a long-term strategic investment.

7.12. Officers will continue to monitor the performance of the CCLA property fund investment.

Investments for policy reasons outside of normal treasury management operations:

7.13. 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.

7.14. During 2020/21 the Council renegotiated 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 is fully collateralised and secured against assets and so a rate of 2.63% was set with reference to State Aid regulations and prevailing market rates.

7.15. The Council lent £0.5m in tranche payments to its 50% joint-owned partnership company YourMK LLP, 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. YourMK LLP was dissolved during 2020/21 and this loan plus accrued interest written off to the HRA.

7.16. 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, the Council has earned a c.2% return. 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.

8. Investment income performance:

8.1. The Council's investments income return for 2020/21 exceeded budget expectations. Projections for the financial year are reported through the Budget Monitoring process and the final position for the year through the Budget Monitoring Outturn report.

8.2. 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:

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%	-0.05%	+0.69%
Mid Year Average (Apr-Sept)	**0.78%**	**0.13%**	**+0.65%**
Q3 (Oct-Dec)	0.57%	-0.08%	+0.65%
Q4 (Jan-Mar)	0.55%	-0.07%	+0.62%
Annual Average (Apr-Mar)	**0.67%**	**0.01%**	**+0.66%**

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 Management Strategy and Capital Strategy.

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

Table 5: Prudential and Treasury Indicators

Prudential Indicator	Indicator	Outturn *
Authorised limit for external debt	----- £770.000m -----	
Operational boundary for external debt	----- £740.000m -----	
Gross borrowing	£458.372m	£458.372m
Capital Financing Requirement (CFR)	£709.081m	£717.191m
Ratio of financing costs to net revenue streams: GF	8.82%	9.84%
HRA	37.50%	37.65%
Limit of fixed interest rates based on net debt	£770.000m	£218.372m
Limit of variable interest rates based on net debt	£77.000m	-£76.285m
Principal sums invested > 365 days	£75.000m	£14.774m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	3.2%
12 months to 2 years	Max. 15% Min. 0%	2.2%
2 years to 5 years	Max. 50% Min. 0%	9.5%
5 years to 10 years	Max. 50% Min. 0%	13.1%
10 years and above	Max. 100% Min. 50%	72.0%

* subject to revision at final outturn.

Appendix A
Global Economic Commentary

USA:

The US economy did not suffer as much damage as the UK economy due to the pandemic. The Democrats won the presidential election in November 2020 and have control of both Congress and the Senate, although power is more limited in the latter. This enabled the Democrats to pass a $1.9trn (8.8% of GDP) stimulus package in March on top of the $900bn fiscal stimulus deal passed by Congress in late December. These, together with the vaccine rollout proceeding swiftly to hit the target of giving a first jab to over half of the population within the President's first 100 days, will promote a rapid easing of restrictions and strong economic recovery during 2021. The Democrats are also planning to pass a $2trn fiscal stimulus package aimed at renewing infrastructure over the next decade. Although this package is longer-term, if passed, it would also help economic recovery in the near-term.

After Chair Jerome Powell spoke on the Fed's adoption of a flexible average inflation target in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed a new inflation target - that "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was 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, (and this year), 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. There is now some expectation that where the Fed has led in changing its policy towards implementing its inflation and full employment mandate, other major central banks will follow, as indeed the Bank of England has done so already. The Fed expects strong economic growth during 2021 to have only a transitory impact on inflation, which explains why the majority of Fed officials project US interest rates to remain near-zero through to the end of 2023. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping treasury yields at historically low levels. However, financial markets in 2021 have been concerned that the sheer amount of fiscal stimulus, on top of highly accommodative monetary policy, could be over-kill leading to a rapid elimination of spare capacity in the economy and generating higher inflation much quicker than the Fed expects. They have also been concerned as to how and when the Fed will eventually wind down its programme of monthly QE purchases of treasuries. These concerns have pushed treasury yields sharply up in the US in 2021 and is likely to have also exerted some upward pressure on gilt yields in the UK.

Appendix A cont.

EU:

Both the roll out and take up of vaccines has been disappointingly slow in the EU in 2021, at a time when many countries are experiencing a sharp rise in cases which are threatening to overwhelm hospitals in some major countries; this has led to renewed severe restrictions or lockdowns during March. This will inevitably put back economic recovery after the economy had staged a rapid rebound from the first lockdowns in Q3 of 2020 but contracted slightly in Q4 to end 2020 only 4.9% below its pre-pandemic level. Recovery will now be delayed until Q3 of 2021 and a return to pre-pandemic levels is expected in the second half of 2022.

Inflation was well under 2% during 2020/21. The ECB did not cut its main rate of -0.5% further into negative territory during 2020/21. It embarked on a major expansion of its QE operations (PEPP) in March 2020 and added further to that in its December 2020 meeting when it also greatly expanded its programme of providing cheap loans to banks. The total PEPP scheme of €1,850bn is providing protection to the sovereign bond yields of weaker countries like Italy. There is, therefore, unlikely to be a euro crisis while the ECB is able to maintain this level of support.

China:

After a concerted effort to get on top of the virus outbreak in Q1 of 2020, economic recovery was strong in the rest of the year; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

Japan:

Three rounds of government fiscal support in 2020 together with Japan's relative success in containing the virus without draconian measures so far, and the roll out of vaccines gathering momentum in 2021, should help to ensure a strong recovery in 2021 and to get back to pre-virus levels by Q3.
World growth. World growth was in recession in 2020. Inflation is unlikely to be a problem in most countries for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Appendix A cont.

Deglobalisation:

Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

Central banks' monetary policy:

During the pandemic, the governments of western countries have provided massive fiscal support to their economies which has resulted in a big increase in total government debt in each country. It is therefore very important that bond yields stay low while debt to GDP ratios slowly subside under the impact of economic growth. This provides governments with a good reason to amend the mandates given to central banks to allow higher average levels of inflation than we have generally seen over the last couple of decades. Both the Fed and Bank of England have already changed their policy towards implementing their existing mandates on inflation, (and full employment), to hitting an average level of inflation. Greater emphasis could also be placed on hitting subsidiary targets e.g. full employment before raising rates. Higher average rates of inflation would also help to erode the real value of government debt more quickly.