London Borough of Haringey

Treasury Management Strategy Statement 2023/24

1. Introduction

1.1. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.3. Investments held for service purposes or for commercial profit are considered in section 6 of this report, the Investment Strategy.

2. External Context – provided by the Council's appointed treasury advisor, Arlingclose

Economic background

2.1. The ongoing impact on the United Kingdom (UK) from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Council's treasury management strategy for 2023/24.

2.2. In December 2022, the Bank of England (BoE) increased the Bank Rate by 0.50% to 3.50%. This followed a 0.75% rise in November which was the largest single rate hike since 1989, and the ninth successive increase since December 2021. The decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two members preferring to maintain the Bank Rate at 3.00% and one member preferring to increase the Bank Rate by 0.75% to 3.75%.

2.3. The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than previous forecasts (due in part to the government's support package for household energy costs), inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

2.4. The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will continue to decline throughout 2023 and the first half of 2024 due to the squeeze on household income from higher energy costs and goods prices.

2.5. CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and expectations are that it will fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if the Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

2.6. The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.7%. Earnings were up strongly in nominal terms by 6.1% for total pay and regular pay. However, when inflation is factored in, real pay for both measures was -2.7%. Looking forward, the November MPR showed the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

2.7. Interest rates have also been rising sharply in the United States (US), with the Federal Reserve increasing the range on its key interest rates by 0.50% in December 2022 to 4.25%-4.50%. This followed four successive 0.75% rises in the pace of tightening that has seen rates increase from 0.25% - 0.50% in March 2022.

2.8. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% between July and September 2022, a better-than-expected rise, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

2.9. Inflation has been rising consistently in the Euro Zone since the start of 2022, hitting an annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an expansion of just 0.3% in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.5% in December, taking it main refinancing rate to 2.5% and deposit facility rate to 2.0%

Credit Outlook

2.10. Credit default swap (CDS) prices generally followed an upward trend throughout 2022, indicating higher credit risk. The CDS prices have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook. However, the prices remain well below the levels seen at the beginning of the Covid-19 pandemic.

2.11. CDS price volatility has been higher in 2022 compared to 2021, and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

2.12. The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

2.13. There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

2.14. However, the institutions on the Council's treasury management adviser Arlingclose's counterparty list remain well-capitalised and the counterparty advice provided on both recommended institutions and maximum duration remain under constant review, and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2022)

2.15. The Council's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

2.16. While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remain persistently higher.

2.17. Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.50%, 3.50%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium, and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty events.

2.18. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

2.19. For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 3.50%, and that new long-term loans will be borrowed at an average rate of 4.50%.

3. <u>Local Context</u>

3.1. On 31 December 2022, the Council held £783.5m of borrowing and £53.2m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast (Capital Financing Requirement)

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
General Fund CFR	567.9	683.9	811.6	956.7	1,129.8	1,269.9	1,356.7
HRA CFR	404.7	487.3	627.9	825.5	1,049.6	1,209.1	1,326.7
Total CFR	**972.6**	**1,171.2**	**1,439.5**	**1,782.2**	**2,179.4**	**2,479.0**	**2,683.4**
Less: Other debt liabilities*	-26.8	-22.0	-17.6	-13.1	-10.4	-9.6	-8.8
Loans CFR	**945.8**	**1,149.2**	**1,421.9**	**1,769.1**	**2,169.0**	**2,469.4**	**2,674.6**
Less: Internal borrowing	-245.4	-169.3	-187.0	-210.2	-235.2	-262.3	-310.3
CFR Funded by External Borrowing	**700.4**	**979.9**	**1,234.9**	**1,558.9**	**1,933.8**	**2,207.1**	**2,364.3**
Breakdown of External Borrowing:							
Existing borrowing**	700.4	778.3	661.3	618.3	607.4	596.6	585.8
New borrowing to be raised	-	201.6	573.6	940.6	1,326.4	1,610.5	1,778.5

* leases and PFI liabilities that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing

3.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. The Council has an increasing CFR due to the capital programme, but minimal treasury investments and will therefore be required to borrow up to £1,778.5m over the forecast period.

3.3. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during the course of the medium-term financial strategy (MTFS).

3.4. The capital plans which underpin the borrowing requirement above are dealt with in the Council's main budget report (in particular the Capital Strategy section). The Council's capital programme is robustly scrutinised and tested to ensure that the capital plans are affordable and prudent. Table 1 shows the five-year effects of the Council's capital programme; however all capital plans are assessed in their entirety (i.e., some schemes are for a greater than five year time frame).

3.5. The breakdown of the forecast borrowing position at each financial year end for both the General Fund and the HRA is shown in table 2 below:

Table 2: Year-end Borrowing Position Summary

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
General Fund borrowing	359.4	472.4	586.8	713.2	864.0	977.8	1,017.4
HRA borrowing	341.0	507.5	648.1	845.7	1,069.8	1,229.3	1,346.9
Total borrowing	**700.4**	**979.9**	**1,234.9**	**1,558.9**	**1,933.8**	**2,207.1**	**2,364.3**

Liability Benchmark

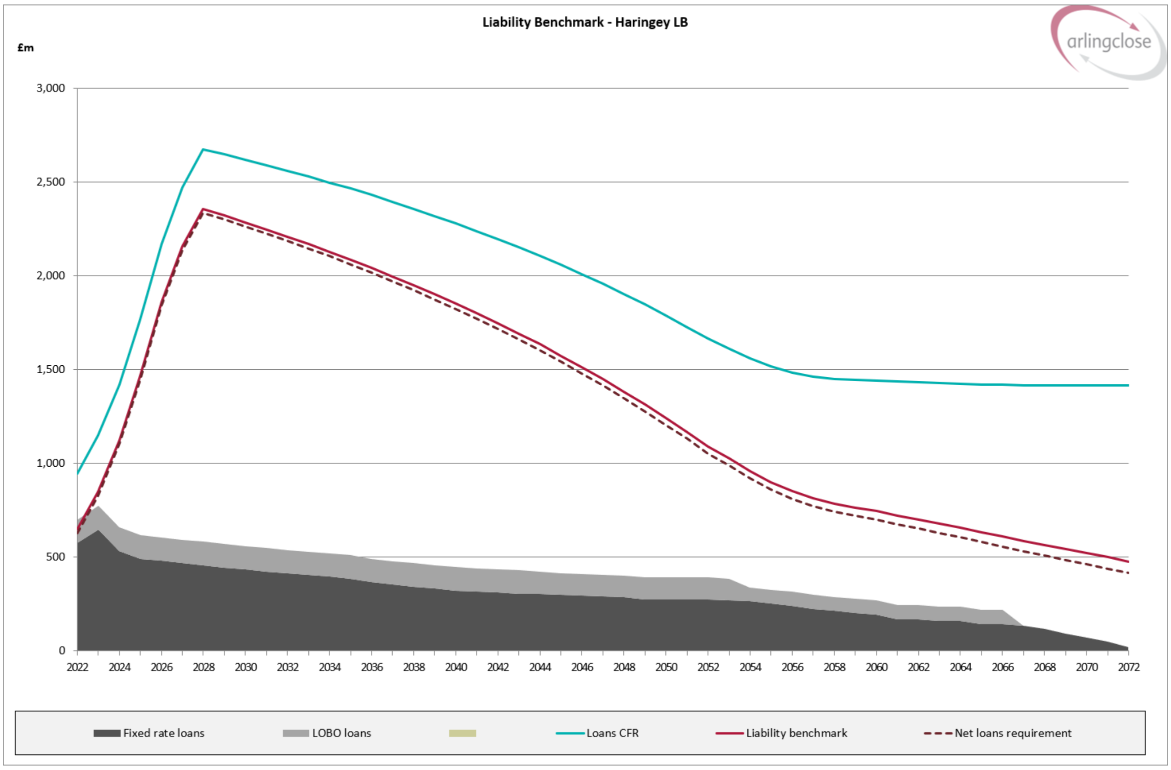
3.6. The liability benchmark has been calculated to compare the Council's actual borrowing against an alternative strategy. The liability benchmark shows the lowest risk level of borrowing. This assumes the same borrowing forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain sufficient liquidity but minimise credit risk.

3.7. The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or a long-term investor in the future. This is important in developing the Council's strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 3: Prudential Indicator – Liability Benchmark

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m	31.3.28 Forecast £m
Loans CFR	945.8	1,149.2	1,421.9	1,769.1	2,169.0	2,469.4	2,674.6
Less: Balance Sheet resources	-316.6	-322.2	-341.4	-322.2	-326.9	-331.7	-339.9
Net loans requirement	**629.2**	**827.0**	**1,080.5**	**1,446.9**	**1,842.1**	**2,137.7**	**2,334.7**
Plus: Liquidity allowance	20.0	20.0	20.0	20.0	20.0	20.0	20.0
Liability Benchmark	**649.2**	**847.0**	**1,100.5**	**1,466.9**	**1,862.1**	**2,157.7**	**2,354.7**

3.8. The long-term liability benchmark assumes the same capital expenditure funded by borrowing as included in the CFR, minimum revenue provision on new capital expenditure based on a 25-year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the chart on the following page together with the maturity profile of the Authority's existing borrowing.



4. Borrowing Strategy

4.1. On 31 December 2022, the Council held £783.5m of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to increase its borrowing by up to £534.5m by the end of 2023/24. The Council may also borrow additional sums to pre-fund future years' borrowing requirements, provided this does not exceed the authorised limit for borrowing as set out in table 4 of this report.

Objectives

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

Strategy

4.3. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The scale of the Council's capital programme, and the need to diversify the Council's debt portfolio to further minimise refinancing risk means that long term borrowing will be required during 2023/24. Therefore, the Council's strategy will be to fulfil its borrowing requirement during the financial year with a mixture of short-term and long-term borrowing.

4.4. With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow using short-term loans to finance the General Fund's capital programme. However, a significant portion of the HRA capital programme will continue to be financed by long-term borrowing, in line with the HRA business plan.

4.5. By doing so, the Council aims to reduce net borrowing costs and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.6. The Council has in recent years raised all its long-term borrowing from the Public Works Loan Board (PWLB) but will consider long-term loans from other sources including banks, pension funds and other local authorities, and may investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council has not done this in the past and intends to avoid this activity in order to retain its access to PWLB loans.

4.7. Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

4.8. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

Sources of Borrowing

4.9. The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Haringey Pension Fund and the London Collective Investment Vehicle)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other Sources of Debt Finance

4.10. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire Purchase
- Private Finance Initiative
- Sale and Lease Back

Municipal Bonds Agency

4.11. UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Corporate Committee.

LOBOs

4.12. The Council holds £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option 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. £125m of these LOBOs have options exercisable during 2023/24, and with interest rates having risen sharply recently, there is now a reasonable likelihood that lenders will explore their ability to exercise their options. If they do, the Council will take the option to repay the LOBO loans to reduce refinancing risk in later years.

4.13. Some LOBO lenders may be open to negotiating premature exit terms from LOBO loans via payment of a premium to the lender. The Council's policy will be to exit LOBO agreements if the costs of replacing the loans, including all premium, transaction and funding costs, generate a material net revenue saving for the Council over the life of the loan in net present value terms, and all costs are consistent with Haringey's approved medium term financial strategy. The decision to repay a LOBO loan will be determined by the S151 Officer in consultation with the lead Cabinet member for Finance, in line with Haringey's constitution.

4.14. When loans are prematurely repaid, there is usually a premium payable to the lender, to compensate them for interest forgone at the contractual rate, where prevailing interest rates are lower. The Council would need to refinance LOBOs by raising borrowing for both the original sum borrowed, and the premium payable to the lender. However, this type of arrangement can prove beneficial where interest savings exceed premium costs. Replacing LOBOs that contain an option for lenders to increase the rate, with fixed rate debt would reduce refinancing and interest rate risk.

4.15. As the Council's borrowing portfolio grows in line with its capital spending plans, the LOBOs will continue to shrink as a proportion of the Council's total borrowing.

Short-term and Variable Rate Loans

4.16. These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk.

Debt Rescheduling

4.17. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Borrowing Limits

4.18. The Council's total borrowing limits are set out in table 4 below.

4.19. The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e., not net of investments) and is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). The indicator separately identifies borrowing from other long-term liabilities such as finance leases. The Authorised Limit has been set on the estimate of the most likely, prudent but not worst-case scenario with sufficient headroom over and above this to allow for unusual cash movements.

4.20. The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst-case scenario but without the additional headroom included within the Authorised Limit. The Operational Boundary and Authorised Limit apply at the total level.

4.21. The Chief Finance Officer has the delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Corporate Committee.

Table 4: Borrowing Limits

	2022/23 Limit £m	2023/24 Limit £m	2024/25 Limit £m	2025/26 Limit £m	2026/27 Limit £m	2027/28 Limit £m
Authorised limit - borrowing	1,286.0	1,452.3	1,817.7	2,212.2	2,487.7	2,634.5
Authorised limit - PFI & Leases	25.7	23.2	17.3	13.7	12.7	11.7
Authorised limit - total external debt	**1,311.7**	**1,475.5**	**1,835.0**	**2,225.9**	**2,500.4**	**2,646.2**
Operational boundary - borrowing	1,236.0	1,402.3	1,767.7	2,162.2	2,437.7	2,584.5
Operational boundary - PFI & Leases	23.4	21.1	15.7	12.4	11.5	10.6
Operational boundary - total external debt	**1,259.4**	**1,423.4**	**1,783.4**	**2,174.6**	**2,449.2**	**2,595.1**

5. Treasury Investment Strategy

5.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £10.8m and £116m, and similar levels are expected to be maintained in the forthcoming year. It is a requirement of the Markets in Financial Instruments Directive II (MiFID) that the Council maintains an average investment balance of at least £10m, in order to maintain professional client status.

Objectives

5.2. The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) factors when making investment decisions.

Strategy

5.3. As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

5.4. The Council aims to maintain its policy of utilising highly creditworthy and highly liquid investments such as deposits with the Debt Management Office (DMO), AAA rated money market funds and loans to other local authorities on the Arlingclose approved counterparty list. If the Council were to consider diversifying into higher yielding asset classes during 2023/24, in particular for the estimated £10m that is available for longer-term investment due to being required for the MiFID professional client status, this would be the subject of further reports as it would represent a significant change in the treasury investment strategy.

ESG policy

5.5. Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

5.6. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Business Models

5.7. Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved Counterparties

5.8. The Council may invest its surplus funds with any of the counterparty types in table 5 on the following page, subject to the limits shown.

Table 5: Treasury Investment Counterparties and Limits

Sector	Time Limit	Counterparty Limit	Sector Limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£5m	Unlimited
Banks (secured)*	2 years	£5m	Unlimited
Banks (unsecured)*	13 months	£5m	Unlimited
Building societies (unsecured)*	13 months	£5m	£20m
Registered providers (unsecured)*	5 years	£5m	£20m
Money Market Funds	n/a	£5m	Unlimited
Strategic Pooled Funds	n/a	£5m	Unlimited
Real Estate Investment Trusts	n/a	£5m	Unlimited

Minimum Credit Rating

5.9. Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Government

5.10. The Council may invest in loans, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Bank Secured Investments

5.11. Bank secured investments are investments that are secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and Building Societies (unsecured)

5.12. The Council may invest in accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered Providers (unsecured)

5.13. The Council may invest in loans, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money Market Funds

5.14. Money market funds are pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over banks of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic Pooled Funds

5.15. Strategic pooled funds include bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Real Estate Investment Trusts (REITs)

5.16. REITs are publicly traded companies that invest mainly in real estate and pay most of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational Bank Accounts

5.17. The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £10m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk Assessment and Credit Ratings

5.18. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.19. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments

5.20. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.21. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment Limits

5.22. The Council's revenue reserves available to cover investment losses are forecast to be £5 million on 31st March 2024 and £5 million on 31 March 2025. In order that no more than 100% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

5.23. Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 6: Additional Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£5m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates	£5m in total
Money market funds*	£25m in total
Real Estate Investment Trusts	£5m in total

* These limits apply for both Haringey Council and Haringey Pension Fund, so the limit for Money Market Funds is £5m per MMF and £25m aggregate limit for the Council, and £25m for the Pension Fund.

Liquidity Management

5.24. The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

6. Investment Strategy

6.1. The Council invests its money for three broad purposes:

- **Treasury management investments** – where the Council has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure,
- **Service investments** – to support local public services by lending to or buying shares in other organisations,
- **Commercial investments** – where the main purpose of the investment is to earn an investment income

6.2. This investment strategy section of the report meets the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories.

Treasury Management Investments

6.3. The Council typically receives its income in cash (e.g., from taxes and grants) before it pays for its expenditure in cash (e.g., through payroll and invoices). It also holds reserves for future expenditure. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £20 million and £75 million during the 2023/24 financial year.

6.4. The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Service Investments

6.5. The Council lends money to third parties such as its subsidiaries, its suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth.

6.6. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, it will be ensured that any new loans made will remain proportionate to the size of the Council. Balances as at 31 March 2022 were as follows:

Table 7: Loans for service purposes in £ millions as at 31 March 2022

Category of borrower	31.03.22 Balance £m	Loss allowance £m	31.03.22 Net figure in accounts £m
Local Businesses	1.6	(0.9)	0.7
Local Charities	49.0	(43.5)	5.5
Local Residents	0.1	-	0.1
Total Investments	**68.1**	**(44.4)**	**23.7**

6.7. The largest balance above relates to Alexandra Palace debts (shown under local charities). There are historic debt balances owed by the Trust that have not been legally discharged, totalling £49.0m. Much of this loan, £43.5m, is legally outstanding but does not currently have repayments being made, this debt dates back to previous decades when Haringey Council, expended funds on behalf of the Trust. Although the £43.5m debt has not been legally discharged, the Council has agreed that it will only seek to recover this when the Trust is in a position to repay amounts due.

6.8. The remainder of the outstanding amount are more recent loans relating to works carried out on the Ice Rink and West Storage Yard – these are being repaid in line with the original loan agreements. Loans issued to local business are arranged through the Opportunity Investment Fund.

6.9. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

6.10. **Risk assessment**: The Council assesses the risk of loss before entering into and whilst holding service loans by weighing up the service outcomes any such loan could provide against the creditworthiness of the recipient. This is done on a case-by-case basis, given the low number of such arrangements. This forms part of the Council's capital programme, further details of which are in the Council's annual medium term financial strategy.

Commercial Investments: Property

6.11. The Council holds properties which are classified as 'investment properties' in the Council's statement of accounts. These properties are all within the local area, therefore contributing to the Council's local placemaking responsibilities, and include approximately 200 shops, offices and other commercial premises. The revenue stream associated with these (net of the costs of maintaining the properties) forms part of the Council's annual budget, therefore contributing to the resources available to the Council to spend on local public services. Any future acquisitions that the Council makes in this area will be made with reference to the CIPFA Prudential Property Investment guidance issued in 2019.

6.12. The value of investment properties disclosed in the 2021/22 draft statement of accounts was £99.4m.

Capacity, Skills, Culture and Advice

6.13. CIPFA's Treasury Management Code of Practice requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs, and have a full understanding of their roles and responsibilities.

6.14. Given the significant sums of money involved in treasury management, it is crucial for members to have the necessary knowledge to understand the framework by which decisions are made and their impact on the Council's finances. Regular training sessions are arranged for members to keep their knowledge up to date.

6.15. The training needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and other providers in the industry. Staff are also encouraged to study professional qualifications relevant to their responsibilities in the organisation from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

6.16. The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital financing issues. The quality of this service is reviewed by the Council's senior treasury management officers.

6.17. Appropriately skilled and experienced finance and legal officers work with service departments to ensure that the risks associated with any projects they undertake, and compliance with regulation and statutory guidance are properly understood and form a key consideration in any decision-making process.

6.18. The Council's constitution has clearly defined roles and responsibilities for treasury management responsibilities, both for members, committees, and officers.

Investment Indicators

6.19. The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total risk exposure

6.20. The first indicator shows the Council's total exposure to potential investment losses.

Table 8: Total Investment Exposure

Investment Type	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m
Treasury management investments	71.2	65.0	65.0
Service investments: loans	23.7	23.7	23.7
Commercial investments: property	99.4	99.4	99.4
Total Investments	**194.3**	**188.1**	**188.1**

How investments are funded

6.21. Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is challenging to comply with. However, the following investments could be described as funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 9: Investments Funded by External Borrowing

Investment Type	31.3.22 Actual £m	31.03.22 Forecast £m	31.03.23 Forecast £m
Treasury management investments	0.0	0.0	0.0
Service investments: loans	17.6	20.4	20.9
Commercial investments: property	73.6	85.2	87.3
Total Investments	**91.2**	**105.6**	**108.2**

Rate of return received

6.22. This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 10: Investment Rate of Return

Investment Type	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m
Treasury management investments	0.07%	1.55%	3.50%
Service investments: loans	2.86%	2.86%	2.86%
Commercial investments: property	6.29%	4.00%	4.00%
Total Investments	**3.59%**	**3.01%**	**3.68%**

7. Treasury Management Prudential Indicators

7.1. The Council measures and manages its exposures to treasury management risks using the following indicators.

Security

7.2. The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit Risk Indicator	Target
Portfolio average credit rating	Above A-, score of 7 or lower

Liquidity

7.3. The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling 3-month period, without additional borrowing.

Liquidity Risk Indicator	Target
Total cash available within 3 months	£20m

Interest rate exposures

7.4. This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest Rate Risk Indicator	Target
Upper limit on one-year revenue impact of a 1% rise in interest rates	£2m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£2m

7.5. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Maturity structure of borrowing

7.6. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing are shown on the following page:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and above	100%	0%

7.7. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Total short-term borrowing

7.8. The Council has used short term borrowing (under 1 year in duration) from other local authorities extensively in recent years, as an alternative to longer term borrowing from PWLB, due to the lower interest rates, and subsequent revenue savings. Short term borrowing can also be raised from other counterparties such as banks. Short term borrowing exposes the Council to refinancing risk – the risk that interest rates rise quickly over a short period of time and are at significantly higher rates when the loans mature, and new replacement borrowing is required. Bearing this in mind, the Council will set a limit on the total amount of short-term borrowing that has no associated protection against interest rate rises, as a proportion of all borrowing.

Short term borrowing	Target
Upper limit on short-term borrowing that exposes the Council to interest rate rises as a percentage of total borrowing	30%

Long-term treasury management investments

7.9. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Price Risk Indicator	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£10m	£10m	£10m

8. Minimum Revenue Provision Policy Statement

8.1. Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008.

8.2. The Local Government Act 2003 requires the Council to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

8.3. The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

8.4. The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

8.5. The Council's MRP policy was reviewed and revised to better reflect the rules set out in the prudential code and government guidance around prudent provision for repayment of borrowed capital. The revised policy, which took effect from 1 April 2016, ensured that provision for capital repayment is made over a period that is commensurate with the period in which the asset purchased provides benefits.

General Fund MRP policy: borrowing before 2007/08

8.6. The Council calculates MRP on historic debt based on the Capital Financing Requirement (CFR) as at 1 April 2007 at 2% of that CFR, fixed at the same cash value so that the whole debt is repaid after 50 years in total.

8.7. The historic MRP policy for borrowing incurred before 2007/08 led to MRP charges that exceeded what prudence required during the period from 1 April 2007 to 31 March 2016. This resulted in a cumulative charge at 31 March 2016 that was in excess of what is considered prudent and appropriate under the current policy. To reflect the historic over-provision the Council undertakes an annual review to determine whether to make a realignment of MRP charged to the General Fund, using the policy set out above, to recognise the excess sum charged to that point.

8.8. The following conditions will apply to the annual review:

- Total MRP after applying realignment will not be less than zero in any financial year.
- The cumulative total of the MRP realignment will never exceed the amount of historical over-provision calculated to 31 March 2016.

8.9. The table below summarises the historic overprovision position on pre 2008 General Fund expenditure:

Table 11: Summary of historic overprovision of MRP on pre 2008 GF expenditure

Investment Type	£m
MRP provided between 2008-2016 under previous policy to 31.3.2016	78.0
MRP required to be provided between 2008-2016 under current policy	45.2
Overprovision as at 31.3.2016	32.8

8.10. The remaining overprovision of MRP as at 31.3.2023 was £2.7m. The estimated MRP charges relating to pre 2008 general fund expenditure are summarised in the table below, due to the historic overprovision, MRP charges are estimated to be nil until part way through 2022/23 at which point the historic overprovision will be cleared.

Table 12: Estimated MRP charges on GF pre 2008 expenditure

	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m
MRP charge on pre-2008 GF expenditure	5.0	5.0	5.0	5.0	5.0	5.0
Less: Historic overprovision	(2.7)	0.0	0.0	0.0	0.0	0.0
Net MRP charge for pre 2008 expenditure	2.3	5.0	5.0	5.0	5.0	5.0

General Fund MRP policy: prudential borrowing from 2007/08

8.11. For capital expenditure incurred on schemes after 31 March 2008, MRP will be determined by charging the expenditure over the expected useful life to the relevant asset as the principal repayment based on the annuity method in accordance with Option 3 of the guidance.

8.12. This means that MRP will be calculated on an annuity basis (like many domestic mortgages) over the estimated life of the asset, at an appropriate interest rate. Estimated life periods will be determined by the Section 151 Officer under delegated powers.

8.13. In accordance with the provisions in the guidance, MRP will be first charged in the financial year following the one in which the entire asset to which the charge relates, becomes fully operational.

8.14. Financial agreements such as loans, investments or where assets are to be acquired for future development (including where capital receipts are part of the business case), will not, at the discretion of the CFO, attract MRP. This discretion will be applied where it is reasonable to assume that the initial capital investment will be returned to the Council in full at maturity or over a defined period.

Housing Revenue Account (HRA) MRP Policy

8.15. There is no statutory requirement to make an annual MRP charge for HRA assets, and the Council does not currently plan to do this given the current low level of debt per property that the Council holds, and the fact that sums charged as depreciation in the HRA are spent on major repairs to the Council's housing stock to ensure they remain in suitable condition. This policy will be kept under annual review.

Concession Agreements

8.16. MRP in relation to concession agreements (e.g., PFI contracts) and finance leases are calculated on an asset life method using an annuity repayment profile, consistent with the method for all prudential borrowing since 2007/08. Estimated life periods will be determined under delegated powers.

Finance Leases

8.17. For assets acquired by finance leases, including leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

Statutory capitalisations

8.18. For expenditure which does not create a fixed asset but is statutorily capitalised and subject to estimated life periods that are referred to in the guidance, these estimated periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

8.19. Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, at the discretion of the Section 151 Officer.

8.20. The Section 151 Officer may approve that such debt repayment provision may be made from capital receipts or from revenue provision.

9. <u>Related Matters</u>

9.1. The CIPFA Code requires the Council to include the following in its treasury management strategy.

Financial Derivatives

9.2. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g., interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g., LOBO loans and callable deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e., those that are not embedded into a loan or investment).

9.3. The Council will only use standalone financial derivatives (such as swaps, forwards, futures, and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be considered when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

9.4. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk will be included to count against the counterparty credit limit and the relevant foreign country limit.

9.5. In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Housing Revenue Account

9.6. On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive

9.7. The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Director of Finance (S151 Officer) believes this to be the most appropriate status.

10. Financial Implications

10.1. The budget for investment income in 2023/24 is £2.3m based on an average investment portfolio of £65 million at an interest rate of 3.50%. This is assumed to remain constant throughout the MTFS period.

10.2. The budget for debt interest paid in 2023/24 is detailed in table 13 below for both the General Fund and HRA. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against the budget will be correspondingly different.

10.3. Table 13 demonstrates the revenue budgets in both the General Fund and HRA for both interest costs on borrowing and minimum revenue provision (MRP) charges. The Council's capital programme is moving to a financing strategy that seeks to ensure that investment via the capital programme is self-financing. The self-financing schemes will normally only process if they produce a reduction in expenditure that includes reductions enough to cover the cost of financing the investment. The level of these savings is demonstrated in the table below.

Table 13: Revenue budget for interest costs and MRP

	2022/23 Budget £m	2023/24 Forecast £m	2024/25 Forecast £m	2025/26 Forecast £m	2026/27 Forecast £m	2027/28 Forecast £m
MRP - pre 2008 expenditure	2.3	5.0	5.0	5.0	5.0	5.0
MRP - post 2008 expenditure	11.1	13.7	17.2	21.4	26.0	30.6
Total MRP	**13.4**	**18.7**	**22.2**	**26.4**	**31.0**	**35.6**
Interest Costs (GF)	11.3	16.9	23.3	25.1	30.0	33.1
Total Gross Capital Financing Costs (GF)	**24.7**	**35.6**	**45.5**	**51.5**	**61.0**	**68.7**
Offsetting Savings for self-financing schemes	-8.8	-12.7	-18.8	-23.5	-29.5	-33.1
Total Net Capital Financing Costs (GF)	**15.9**	**22.9**	**26.7**	**28.0**	**31.5**	**35.6**
Interest Costs (HRA)	**14.9**	**18.6**	**27.4**	**36.8**	**44.9**	**50.3**

11. Other Options Considered

11.1. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance (S151 Officer), having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed on the following page.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex A – Arlingclose Economic & Interest Rate Forecast - December 2022

Underlying assumptions:

- The influence of the previous UK Government's mini budget on interest rates and yields continues to wane following the more responsible approach shown by the current administration.
- Volatility in global markets continues as investors seek to understand the extent to which central banks are willing to tighten their monetary policy, as evidence of recessionary conditions builds. Investors appear to be more cautious, often willing to price in the downturn in growth and easing financial conditions. This raises the risk that central banks may incur a policy error by tightening too aggressively.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power and recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy in 2022, and the lingering effects of the autumn mini budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains gloomy.
- Demand for labour appears to be declining, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. The Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight, and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short-term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March, and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until wage growth eases. Arlingclose forecast rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.

- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

Interest Rate Forecast:

The table below shows the most recent interest rate forecast provided by Arlingclose.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%