

TREASURY MANAGEMENT STRATEGY STATEMENT

AND

ANNUAL INVESTMENT STRATEGY

2020/21

Treasury Management Strategy Statement and Annual Investment Strategy 2020/21

1. Introduction

1.1. Background

The City of London Corporation (the City) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the City's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of capital expenditure plans. These capital plans provide a guide to the borrowing needs of the City, essentially the longer-term cash flow planning, to ensure that the organisation can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet risk or cost objectives.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

1.2. The Treasury Management Policy Statement

The City defines its treasury management activities as:

The management of the organisation's investments and cash flows, its banking, money market and capital market transaction; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

The City regards the security of its financial investments through the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The City acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.3. CIPFA Requirements

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Court of Common Council (the Court) on 3 March 2010. The Code of Practice was revised in November 2017.

The primary requirements of the Code are as follows:

- (i) The City of London Corporation will create and maintain, as the cornerstones for effective treasury management:
 - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
 - Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- (ii) This organisation (i.e. the Court of Common Council) will receive reports on its treasury management policies, practices and activities, including as a minimum an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.
- (iii) The Court of Common Council delegates responsibility for the implementation and regular monitoring of its treasury management policies to the Finance Committee and the Financial Investment Board; the execution and administration of treasury management decisions is delegated to the Chamberlain, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- (iv) The Court of Common Council nominates the Audit and Risk Management Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy. The capital strategy provides a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services as well as an overview of how the associated risk is managed and the implications for future financial sustainability. The Treasury Management Strategy Statement is reported separately from the Capital Strategy. This ensures the separation of the core treasury function under security, liquidity and yield principles from the policy and commercial investments usually driven by expenditure on an asset.

1.4. Treasury Management Strategy for 2019/20

The Local Government Act 2003 (the Act) and supporting regulations require the City to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the City's capital investment plans are affordable, prudent and sustainable. The City's Prudential Indicators are set in its annual Budget Report

and Medium-Term Financial Strategy, while Treasury Indicators are established in this report (Appendix 3).

The Act requires the Court of Common Council to set out its treasury strategy for borrowing (section 7 of this report) and to prepare an Annual Investment Strategy (section 8 of this report). The Investment Strategy sets out the City's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2020/21 in respect of the required aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the City's treasury adviser, Link Asset Services, Treasury Solutions.

The strategy covers:

- the capital expenditure plans and the associated prudential indicators
- the minimum revenue provision (MRP) policy
- the current treasury position
- treasury indicators which limit the treasury risk and activities of the City
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers.

These elements cover the requirements of the local Government Act 2003, the CIPFA Prudential Code, the MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

1.5. Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the City Fund to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions.

2. Capital Expenditure, Capital Financing and the Underlying Borrowing Requirement

The City's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

The City's capital expenditure plans in respect of its local authority functions (the City Fund) are detailed in the 2020/21 Budget Report and Medium-Term Financial Strategy, which also contains the City's Prudential Indicators. The Prudential

Indicators summarise the City Fund's annual capital expenditure and financing plans for the medium term.

Estimate of Capital Expenditure and Financing (City Fund)

Table 1	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Capital Expenditure:					
Non-HRA	67.2	74.8	102.0	288.7	304.5
HRA	10.9	16.2	48.7	44.5	18.4
Total	78.1	91.0	150.7	333.2	322.9
Financed by:					
Capital grants	15.8	24.1	37.8	43.4	24.7
Capital reserves	14.7	33.7	10.6	0.0	175.0
Revenue	47.6	33.2	61.3	19.2	12.8
Total	78.1	91.0	109.7	62.6	212.5
Net financing need:	0.0	0.0	41.0	270.6	110.4

The Prudential Indicators also establish the City Fund's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the City Fund's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource (the net financing need in Table 1), will increase the CFR.

Estimate of the Capital Financing Requirement (City Fund)

Table 2	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Non-HRA	43.6	38.4	56.5	317.2	420.6
HRA	0.0	0.0	22.0	26.6	26.0
Total	43.6	38.4	78.5	343.8	446.6

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used. The City's MRP Policy is detailed in Appendix 3.

City's Cash

The City also delivers capital expenditure outside of its capacity as a local authority, via City's Cash. As with the City Fund, any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the

City's Cash borrowing requirement. Table 3 summarises the planned City's Cash borrowing over the next few years.

City's Cash Borrowing

Table 3	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Borrowing	£125m	£250m	£250m	£450m	£450m

As with the MRP for the City Fund, borrowing for City's Cash will be reduced gradually over time through the application of a debt financing reserve as set out in the City's Cash Borrowing Policy Statement (Appendix 9).

3. Current Portfolio Position

The City's treasury portfolio position at 31 December 2019 comprised:

Treasury Portfolio				
	Actual 31/03/19 £m	Actual 31/03/19 %	Current 31/12/19 £m	Current 31/12/19 %
Treasury investments				
Banks	£318.7	37%	£448.8	39%
Building societies (rated)	£50.0	6%	£139.0	12%
Local authorities	£15.0	2%	£20.0	2%
Liquidity funds	£317.2	37%	£318.7	28%
Ultra-short dated bond funds	£65.0	8%	£65.0	6%
Short dated bond funds	£100.0	12%	£150.0	13%
Total treasury investments	£865.9	100%	£1,141.5	100%
Treasury external borrowing				
Short term market debt (City's Cash)	£125.0	100%		
Long term market debt (City's Cash)			£250.0	100%
Total external borrowing	£125.0	100%	£250.0	100%

The overall weighted average rate of return on investments was 1.42% as at 31 December 2019 compared to 1.07% as at 31 March 2019.

4. Treasury Indicators for 2020/21 – 2022/23

Treasury Indicators (as set out in Appendix 3) are relevant for the purposes of setting an integrated treasury management strategy.

5. Prospects for Interest Rates

The City of London has appointed Link Asset Services (Link) as its treasury advisor and part of their service is to assist the City to formulate a view on interest rates. Appendix 1 draws together a number of forecasts for both short term (Bank Rate – also known as “the Bank of England base rate”) and longer term interest rates and

Appendix 2 provides a more detailed economic commentary. The following table and accompanying text below gives the Link central view.

	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 years	25 year	50 year
Mar 2020	0.75	2.30	2.50	3.00	2.90
Jun 2020	0.75	2.30	2.50	3.00	2.90
Sep 2020	0.75	2.40	2.60	3.10	3.00
Dec 2020	0.75	2.40	2.60	3.20	3.10
Mar 2021	1.00	2.50	2.70	3.30	3.20
Jun 2021	1.00	2.60	2.80	3.40	3.30
Sep 2021	1.00	2.70	2.90	3.50	3.40
Dec 2021	1.00	2.80	3.00	3.60	3.50
Mar 2022	1.00	2.90	3.10	3.70	3.60
Jun 2022	1.25	2.90	3.10	3.80	3.70
Sep 2022	1.25	3.00	3.30	3.80	3.70
Dec 2022	1.25	3.00	3.20	3.90	3.80
Mar 2023	1.25	3.10	3.30	3.90	3.80

The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU at some point in time. The result of the General Election has removed some uncertainty but it is still unclear whether agreement will be reached with the EU on a trade deal before December 2020.

The Monetary Policy Committee's (MPC) decision to leave Bank Rate unchanged at 0.75% during 2019 is in the context of ongoing uncertainty over Brexit. At its November meeting the MPC registered concerns over the outlook for the domestic economy and global growth. If those concerns were to materialise then the MPC would likely cut Bank Rate; if they dissipate, interest rates would probably rise at a "gradual pace and to a limited extent".

Bond yields continued to fall to extraordinarily low levels in the first half of 2019 as expectations of a recession in the world's largest economy, the US, mounted and against a general background of a downturn in global economic growth combined with low inflation. Eurozone bond yields have been negative and, at times, the US yield curve has inverted (ten year yields have been below shorter term yields). This situation has partially reversed since the autumn and if global growth and the US economy fare better than expected this year it is likely that investors will sell out of "risk-off" assets such as US treasuries and UK gilts, which will increase yields. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period. Therefore, economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earning.
- PWLB borrowing interest rates were on a major falling trend during the first half of 2019-20 but then increased by 100 basis points on 9 October 2019, when HM Treasury increased the margin added to the prevailing gilt rate that is used to determine the interest rate on new loans to local authorities. As a result the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%.
- Because borrowing rates are expected to be higher than investment rates, any new borrowing undertaken by the City will have a “cost of carry” (the difference between higher borrowing costs and low investment returns) in the near term which will most likely incur a revenue cost.

6. Interest Rate Exposure

The revised Prudential Code removes the requirement to set treasury indicators for fixed and variable interest rate exposure. Instead the City is required to set out how it intends to manage interest rate exposure.

This organisation will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements and management information arrangements.

It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

7. Borrowing Strategy

The borrowing strategy is developed from the capital plans and prospect for interest rates outlined in sections 2 and 5 above, respectively.

For both the City Fund and City’s Cash, the capital expenditure plans create borrowing requirements and the borrowing strategy aims to make sure that sufficient cash is available to ensure the delivery of the City’s capital programme as planned.

The City can choose to manage the borrowing requirements through obtaining external debt from a variety of sources; through the temporary use of its own cash resources (“internal borrowing”); or via a combination of these methods.

7.1. City Fund

The City Fund has a positive Capital Financing Requirement, and this is expected to grow in the next few years (see table 2 above). As the City Fund currently has no

external debt, it is therefore maintaining an under-borrowed position which is forecast to increase if the City Fund does not acquire external debt. This means that the capital borrowing need is being managed within internal resources, i.e. cash supporting the City Fund's reserves, balances and cash flow is being used as a temporary measure. This strategy is prudent because it helps the City Fund to minimise borrowing costs in the near term and because it leads to lower investment balances which reduces counterparty risk. Against these advantages the City is conscious of the increased exposure to interest rate risk that is inherent in internal borrowing (i.e. the risk that the City Fund will need to replace internal borrowing with external borrowing in the future when interest rates are high).

Therefore, against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Chamberlain will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. For example,

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing will be postponed.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

Any decisions will be reported to the Finance Committee and the Court of Common Council at the next available opportunity.

The City must set two treasury indicators representing the upper limits for the total amount of external debt for City Fund. These limits are required under the Prudential Code in order to ensure borrowing is affordable and is consistent with the City Fund's capital expenditure requirements.

- The **operational boundary for external debt** should represent the most likely scenario for external borrowing. It is acceptable for actual borrowing to deviate from this estimate from time to time. The proposed limit is set to mirror the estimated CFR for the forthcoming year and the following two years.
- The **authorised limit for external debt** is the maximum threshold for external debt for over 2020/21, 2021/22 and 2022/23. This limit is required by the Local Government Act 2003 and is set above the operational boundary to ensure that the City is not restricted in the event of a debt restructuring opportunity.

The proposed limits for 2020/21 are set out in Appendix 3.

The City is also required to set a treasury indicator in respect of the maturity structure of external debt to ensure that the external debt portfolio remains appropriately balanced over the long term. Under the revised Treasury Management Code of

Practice, the City is required to set limit for all borrowing (i.e. both fixed rate and variable debt), and the proposed limits are detailed in Appendix 3.

7.2. City's Cash

The capital expenditure plans for City's Cash have also created a borrowing requirement. During 2019/20, this financing need was met through the issuance of £250m market debt which was secured through a private placement exercise. A further £200m of market debt has been arranged for drawdown in 2021/22. It is not anticipated that any new external borrowing will be acquired by City's Cash. However, the Chamberlain will keep this position under review and in doing so will have regard for liquidity requirements, interest rate risk and the implications for the revenue budget.

The regulatory framework established through the CIPFA professional codes and MHCLG guidance pertains to the City's local authority function, the City Fund. To facilitate effective management of the City's Cash borrowing requirement, this organisation has adopted the City's Cash Borrowing Policy Statement (Appendix 9), which sets out the principles for effectively managing the risks arising from borrowing on behalf of City's Cash. Under this framework, the City has resolved to establish two further treasury indicators, which will help the organisation to ensure its borrowing plans remain prudent, affordable and sustainable:

- **Estimates of financing costs to net revenue stream.** This indicator is given as a percentage and establishes the amount of the City's Cash net revenue that is used to service borrowing costs.
- **Overall borrowing limits.** This indicator represents an upper limit for external debt which officers cannot exceed.

The proposed indicators for 2020/21 are set out in Appendix 3 alongside the City Fund treasury indicators.

7.3. Policy on borrowing in advance of need

The City will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the City can ensure the security of such funds.

7.4. Debt rescheduling

The City does not anticipate any debt rescheduling in the near term. However, should any opportunities for debt rescheduling arise (through a decrease in borrowing rates, for instance), such cases will need to be considered in the context of the current treasury position and the size of the cost of debt repayment (i.e. any penalties incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;

- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

All rescheduling will be reported to the Court of Common Council, at the earliest meeting following its action.

7.5. Sources of borrowing

Historically, the main source of borrowing for UK local authorities has been the PWLB. On 9 October 2019, the Government increased the margin over gilt yields payable on new loans by local authority borrowers by 100 basis points to 180 basis points. Local authorities have recourse to other sources of external borrowing including financial institutions, other local authorities and the Municipal Bonds Agency. The extent to which any of these options proves cheaper than the PWLB Certainty Rate is still evolving but will be kept under review.

8. Annual Investment Strategy

8.1. Investment Policy

The City of London's investment policy will have regard to the MHCLG's Guidance on Local Government Investments ("the Guidance"), the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes 2017 ("the CIPFA TM Code") and CIPFA Treasury Management Guidance Notes 2018.

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, (e.g. commercial property), are covered in the Capital Strategy, (a separate report).

The City's investment priorities are:

- (a) security; and
- (b) liquidity.

The City will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the City is low in order to give priority to the security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the City will not engage in such activity.

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the City applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration, the City will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties. Investment instruments identified for use in the financial year are listed in Appendix 4 under the ‘specified’ and ‘non-specified’ investments categories.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18-month deposit would still be non-specified even if it has only 11 months left until maturity.

The City will also set a limit for the amount of its investments which are invested for longer than 365 days (see Appendix 3).

8.2. Creditworthiness policy

The primary principle governing the City’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the City will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the City’s prudential indicators covering the maximum principal sums invested.

The Chamberlain will maintain a counterparty list in compliance with the following criteria and will revise these criteria and submit them to the Financial Investment Board for approval as necessary. These criteria are separate to those which determine which types of investment instruments are classified as either specified or non-specified as it provides an overall pool of counterparties considered high quality which the City may use, rather than defining what types of investment instruments are to be used.

Regular meetings are held involving the Chamberlain, the Deputy Chamberlain, Corporate Treasurer and members of the Treasury team, where the suitability of prospective counterparties and the optimum duration for lending is discussed and agreed.

Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of a possible longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty would result in a temporary suspension, which will be reviewed in light of market conditions.

All credit ratings will be monitored daily. The City is alerted to credit warnings and changes to ratings of all three agencies through its use of the Link creditworthiness service.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 – good credit quality – the City will only use banks which:
 - (i) are UK banks; and/or
 - (ii) are non-UK and domiciled in a country which has a minimum sovereign long-term rating of AAA (Fitch rating)

and have, as a minimum the following Fitch, credit rating:

- (i) Short-term – F1
 - (ii) Long-term – A
- Banks 2 – Part nationalised UK banks – Royal Bank of Scotland ring-fenced operations. This bank can be included if it continues to be part nationalised, or it meets the ratings in Banks 1 above.
- Banks 3 – The City's own banker (Lloyds Banking Group) for transactional purposes if the bank falls below the above criteria, although in this case, balances will be minimised in both monetary size and duration.
- Bank subsidiary and treasury operation - The City will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above. This criteria is particularly relevant to City Re Limited, the City's Captive insurance company, which deposits funds with bank subsidiaries in Guernsey.
- Building Societies – The City may use all societies which:
 - (i) have assets in excess of £10bn; or
 - (ii) meet the ratings for banks outlined above

- Money Market Funds CNAV* – with minimum credit ratings of AAA/mmf
- Money Market Funds (MMFs) LVNAV* – with minimum credit ratings of AAA/mmf
- Money Market Funds (MMFs) VNAV* – with minimum credit ratings of AAA/mmf
- Ultra-Short Dated Bond Funds with a credit rating of at least AAA/f (previously referred to as Enhanced Cash Plus Funds)
- Short Dated Bond Fund – These funds typically do not obtain their own standalone credit rating. The funds will invest in a wide array of investment grade instruments, the City will undertake all necessary due diligence to ensure a minimum credit quality across the funds underlying composition is set out within initial Investment Manager Agreements and actively monitor the on-going credit quality of any fund invested.
- UK Government – including government gilts and the debt management agency deposit facility.
- Local authorities

A limit of **£500m** will be applied to the use of non-specified investments.

***European Money Market Reform.** Under EU money market reforms implemented in 2018/19, three new classifications of money market funds have been created:

- Constant Net Asset Value (“CNAV”) MMFs – must invest 99.5% of their assets into government debt instruments and are permitted to maintain a constant net asset value.
- Low Volatility Net Asset Value (“LVNAV”) MMFs – permitted to maintain a constant dealing net asset value provided that certain criteria are met, including that the market net asset value of the fund does not deviate from the dealing net asset value by more than 20 basis points.

Variable Net Asset Value (“VNAV”) MMFs – price assets using market pricing and therefore offer a fluctuating dealing net asset value

8.3. Use of additional information other than credit ratings.

Additional requirements under the Code require the City to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties

8.4. Time and monetary limits applying to investments.

The time and monetary limits for institutions on the City’s counterparty list are set out in Appendix 5 as at 31st December 2019. The City may add managers to this list as appropriate.

8.5. UK banks – ring fencing.

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The City will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

8.6. Country limits

The City has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA (Fitch) or equivalent. The country limits list, as shown in Appendix 6, will be added to or deducted from by officers should individual country ratings change in accordance with this policy. It is proposed that the UK (which is currently rated as AA) will be excluded from this stipulated minimum sovereign rating requirement.

8.7. Investment Strategy

In-house funds: The City’s in-house managed funds are both cash-flow derived and also represented by core balances which can be made available for investment over a 2-3 year period. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

Investment returns expectations: On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 2, 2021. Bank Rate forecasts for financial year ends (March) are:

- 2019/20 0.75%
- 2020/21 0.75%
- 2021/22 1.00%

- 2022/23 1.00%

Link consider that the overall balance of risks to economic growth in the UK is probably to the downside due to weight of uncertainties over Brexit as well as a softening global economic picture. The balance of risks to increases in Bank Rate and shorter term PWLB rates are probably similarly to the downside. If a Brexit deal is agreed with the EU and approved by Parliament, the outlook for economic growth is likely to look more positive and increases in Bank Rate will be more likely.

9. Investment Treasury Indicator and Limit

Total principal funds invested for greater than 365 days are subject to a limit, set with regard to the City's liquidity requirements and to reduce the need for an early sale of an investment, and are based on the availability of funds after each year end. The Board is asked to approve the treasury indicator and limit:

Maximum principal sums invested for more than 365 days (up to three years)			
	2020/21	2021/22	2022/23
	£M	£M	£M
Principal sums invested >365 days	500	500	500

10. Investment performance benchmarking

The City will monitor investment performance against Bank Rate and 3- and 6-month London Interbank Bid Rate (LIBID).

11. End of year investment report

At the end of the financial year, the City will report on its investment activity as part of its Annual Treasury Report.

12. External fund managers

A proportion of the City's funds, amounting to £533.7m as at 31 December 2019, are externally managed on a discretionary basis by the following fund managers:

- Aberdeen Standard Investments
- CCLA Investment Management Limited
- Deutsche Asset Management (UK) Limited
- Federated Investors (UK) LLP
- Invesco Global Asset Management Limited
- Legal and General Investment Management
- Payden & Rygel Global Limited
- Royal London Asset Management

The City's external fund managers will comply with the Annual Investment Strategy, and the agreements between the City and the fund managers additionally stipulate guidelines and duration and other limits in order to contain and control risk.

The credit criteria to be used for the selection of the Money Market fund manager(s) is based on Fitch Ratings and is AAA/mmf. The Ultra-Short Dated Bond fund managers (including the Payden & Rygel Sterling Reserve Fund, Federated Sterling

Cash Plus Fund and Aberdeen Standard Investments Ultra Short Duration Sterling Fund) are all rated by Standard and Poor's as AAA.

The City also uses two Short Dated Bond funds managed by Legal and General Investment Management and Royal London Asset Management. Both funds are unrated (as is typical of these instruments). The funds offer significant diversification by being invested in a wide range of investment grade instruments, rated BBB and above and limiting exposure to any one debt issuer or issuance.

13. Policy on the use of external service providers

The City uses Link Asset Services, Treasury Solutions as its external treasury management advisers.

The City recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon its external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The City will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

14. Scheme of Delegation

Please see Appendix 7.

15. Role of the Section 151 officer

Please see Appendix 8.

16. Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. The training needs of members and treasury management officers are periodically reviewed. **Training was most recently undertaken by Members in February 2019.**

APPENDICES

1. Interest Rate Forecasts 2020-2023
2. Link Asset Services view on Economic Background
3. Treasury Indicators 2020/21 – 2022/23 and Minimum Revenue Provision Statement
4. Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

5. Current Approved Counterparties
6. Approved Countries for Investments
7. Treasury Management Scheme of Delegation
8. The Treasury Management Role of the Section 151 Officer
9. City's Cash Borrowing Policy Statement

LINK INTEREST RATE FORECASTS 2020 – 2023

Link Asset Services Interest Rate View													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80

Note: The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective since 1st November 2012.

LINK ASSET SERVICES VIEW ON ECONOMIC BACKGROUND

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report**, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by

e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy \$60bn, whereas it had been reducing its balance sheet by \$50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more

optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period**. At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around

their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. 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 thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. 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. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.**

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly

government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.

- **Weak capitalisation of some European banks, particularly Italian banks.**
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. **There has also been rising anti-immigration sentiment in Germany and France.**
- **In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was potential for a rerun of the 2008 financial crisis, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on some \$19trn of corporate debt in major western economies, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is \$15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.**
- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

TREASURY INDICATORS 2020/21 – 2022/23 AND MINIMUM REVENUE PROVISION STATEMENT

TABLE 1: TREASURY MANAGEMENT INDICATORS	2018/19	2019/20	2020/21	2021/22	2022/23
	actual	probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
Borrowing	143,592	138,355	178,458	443,757	546,639
other long-term liabilities	13,888	13,770	13,653	13,536	13,419
TOTAL	157,480	152,125	192,111	457,293	560,058
Operational Boundary for external debt -					
Borrowing	43,592	38,355	78,458	343,757	446,639
other long-term liabilities	13,888	13,770	13,653	13,536	13,419
TOTAL	57,480	52,125	92,111	357,293	460,058
Actual external debt*	0	0			
Upper limit for total principal sums invested for over 365 days (per maturity date)	£300m	£300m	£500m	£500m	£500m

*Actual external debt at the end of the financial year

TABLE 2: Maturity structure of borrowing during 2019/20	upper limit	lower limit
- under 12 months	50%	0%
- 12 months and within 24 months	50%	0%
- 24 months and within 5 years	50%	0%
- 5 years and within 10 years	75%	0%
- 10 years and above	100%	0%

TABLE 3: CITY'S CASH BORROWING INDICATORS	2018/19	2019/20	2020/21	2021/22	2022/23
	actual	probable outturn	estimate	estimate	estimate
	%	%	%	%	%
Estimates of financing costs to net revenue stream	0.4%	2.9%	4.2%	10.1%	12.1%
	£'000	£'000	£'000	£'000	£'000
Overall borrowing limits	125,000	250,000	250,000	450,000	450,000

MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT 2020/21

To ensure that capital expenditure funded by borrowing is ultimately financed, the City Fund is required to make a Minimum Revenue Provision (MRP) when the Capital Financing Requirement (CFR) is positive. A positive CFR is indicative of an underlying need to borrow and will arise when capital expenditure is funded by 'borrowing', either external (loans from third parties) or internal (use of cash balances held by the City Fund).

MHCLG regulations have been issued which require the Court of Common Council to approve **an MRP Statement** in advance of each year. The regulatory guidance recommends four options for local authorities. Options 1 and 2 relate to government supported borrowing prior to 2008. As the City Fund does not have any outstanding borrowing from this period, these options are not relevant. For any prudential borrowing undertaken after 2008, options 3 and 4 apply:

- **Option 3: Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);
- **Option 4: Depreciation method** – MRP will follow standard depreciation accounting procedures;

For any new borrowing under the prudential financing system, the City Fund will apply the asset life method over the useful economic life of the relevant assets. However, as loan repayments will commence in advance of the assets becoming operational, additional provision will be made in the early years so that MRP is at least equal to the amount of the loan principal repaid. This option provides for a reduction in the borrowing need over the approximate life of the assets.

As in previous years, the City will continue to apply a separate MRP policy for that portion of the CFR which has arisen through the funding of capital expenditure from cash received from long lease premiums which are deferred in accordance with accounting standards. This deferred income is released to revenue over the life of the leases to which it relates, typically between 125 and 250 years.

The City's MRP policy in respect of this form of internal borrowing is based on a mechanism to ensure that the deferred income used to finance capital expenditure is not then 'used again' when it is released to revenue. The amount of the annual MRP is therefore to be equal to the amount of the deferred income released, resulting in an overall neutral impact on the bottom line.

MRP will fall due in the year following the one in which the expenditure is incurred, or the year after the asset becomes operational.

The MRP liability for 2019/20 is **£5,237k** and is estimated at **£979k** for 2020/21

TREASURY MANAGEMENT PRACTICES (TMP 1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where appropriate.

	Minimum ‘High’ Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A,	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A,	Fund Managers
Money Market Funds CNAV	AAA/mmf (or equivalent)	In-house via Fund Managers
Money Market Funds LVNAV	AAA/mmf (or equivalent)	In-house via Fund Managers
Money Market Funds VNAV	AAA/mmf (or equivalent)	In-house via Fund Managers
Ultra-Short Dated Bond Fund	AAA/f (or equivalent)	In-house via Fund Managers
UK Government Gilts	UK Sovereign Rating	In-house & Fund Managers
Treasury Bills	UK Sovereign Rating	Fund Managers
Sovereign Bond issues (other than the UK government)	AAA	Fund Managers

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of £500m will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the categories set out below.

	Minimum Credit Criteria	Use	Maximum	Maximum Maturity Period
Term deposits – other Las (with maturities in excess of one year)	-	In-house	£25m per LA	Three years
Term deposits, including callable deposits – banks and building societies (with maturities in excess of one year)	Long-term A, Short-term F1,	In-house and Fund Managers	£300m overall	Three years
Certificates of deposits issued by banks and building societies with maturities in excess of one year	Long-term A, Short-term F1,	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years
UK Government Gilts with maturities in excess of one year	AAA	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years
UK Index Linked Gilts	AAA	In-house on a buy-and-hold basis and fund managers	£50m Overall	Three years
Short Dated Bond Funds	--	In-house via Fund Managers	£100m per Fund	n/a*

*Short Dated Bonds Funds are buy and hold investments with no pre-determined maturity at time of funding, liquidity access is typically T + 3 or 4.

APPROVED COUNTERPARTIES as at 31 DECEMBER 2019

BANKS AND THEIR WHOLLY OWNED SUBSIDIARIES

FITCH RATINGS		BANK*	LIMIT PER GROUP	DURATION
A+	F1	Barclays Bank PLC (NRFB) Barclays Bank UK PLC (RFB)	£100M	Up to 3 years
A+	F1			
A	F1	Goldman Sachs International Bank	£100M	Up to 3 years
AA	F1+	Handelsbanken PLC	£100m	Up to 3 years
A+	FI+	HSBC (RFB) HSBC (NRFB)	£100M	Up to 3 years
A+	FI+			
A	F1	Lloyds Bank Corporate Markets PLC (NRFB) Lloyds Bank PLC (RFB) Bank of Scotland PLC (RFB)	£150M	Up to 3 years
A+	F1			
A+	F1			
A	F1	NatWest Markets PLC (NRFB) National Westminster Bank PLC (RFB) Royal Bank of Scotland PLC (RFB)	£100M	Up to 3 years
A+	F1			
A+	F1			
A+	F1	Santander UK PLC (RFB)	£100M	Up to 3 years

*Under the ring-fencing initiative, the largest UK banks are now legally required to separate the core retail business into a ring-fenced bank (RFB) and to house their complex investment activities into a non-ring-fenced bank (NRFB). See section 8.2 above for further details.

BUILDING SOCIETIES

FITCH RATINGS		BUILDING SOCIETY	ASSETS	LIMIT PER GROUP	DURATION
A	F1	Nationwide	£238Bn	£120M	Up to 3 years
A-	F1	Yorkshire	£43Bn	£20M	Up to 1 year
A-	F1	Coventry	£46Bn	£20M	Up to 1 year
A-	F1	Skipton	£23Bn	£20M	Up to 1 year
A-	F1	Leeds	£19Bn	£20M	Up to 1 year

MONEY MARKET FUNDS

FITCH RATINGS	MONEY MARKET FUNDS Limit of £100M per fund	DURATION
AAA/mmf	CCLA	Liquid
AAA/mmf	Federated Short-Term Sterling Prime Fund*	Liquid
AAA/mmf	Aberdeen Sterling Liquidity Fund	Liquid
AAA/mmf	Invesco	Liquid
AAA/mmf	Deutsche Liquidity Fund	Liquid

ULTRA SHORT DATED BOND FUNDS

FITCH RATINGS (or equivalent)	ULTRA SHORT DATED BOND FUNDS Limit of £100M per fund	DURATION
AAA/f	Payden Sterling Reserve Fund	Liquid
AAA/f	Federated Sterling Cash Plus Fund*	Liquid
AAA/f	Aberdeen Standard Investments Short Duration Managed Liquidity Fund**	Liquid

*A combined limit of £100m applies to balances across the Money Market Fund and Ultra Short Dated Bond Fund both managed by Federated Standard

SHORT DATED BOND FUNDS

FITCH RATINGS (or equivalent)	SHORT DATED BOND FUNDS Limit of £100M per fund	DURATION
-	Legal and General Short Dated Sterling Corporate Bond Index Fund	Liquid
-	Royal London Investment Grade Short Dated Credit Fund	Liquid

FOREIGN BANKS

(with a presence in London)

FITCH RATINGS		COUNTRY AND BANK	LIMIT PER GROUP	DURATION
		<u>AUSTRALIA</u>		
AA-	F1+	Australia and New Zealand Banking Group Ltd	£100M	Up to 3 years
AA-	F1+	National Australia Bank Ltd	£100M	Up to 3 years
		<u>CANADA</u>		
AA-	F1+	Bank of Montreal	£100M	Up to 3 years
AA-	F1+	Royal Bank of Canada	£100M	Up to 3 years
AA-	F1+	Toronto-Dominion Bank	£100M	Up to 3 years
		<u>GERMANY</u>		
A+	F1+	Landesbank Hessen-Thueringen Girozentrale	£100M	Up to 3 years
		<u>NETHERLANDS</u>		
AA-	F1+	Cooperatieve Rabobank U.A.	£100M	Up to 3 years
		<u>SINGAPORE</u>		
AA-	F1+	DBS Bank Ltd.	£100M	Up to 3 years
AA-	F1+	United Overseas Bank Ltd.	£100M	Up to 3 years
		<u>SWEDEN</u>		
AA-	F1+	Skandinaviska Enskilda Banken AB	£100M	Up to 3 years
AA-	F1+	Swedbank AB	£100M	Up to 3 years
AA	F1+	Svenska Handelsbanken	£100M	Up to 3 years

LOCAL AUTHORITIES

LIMIT OF £25M PER AUTHORITY
Any UK local authority

APPROVED COUNTRIES FOR INVESTMENT

This list is based on those countries which have sovereign ratings of AAA as at 21 January 2020.

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg*
- Netherlands
- Norway *
- Singapore
- Sweden
- Switzerland
- United States

AA

- United Kingdom

* Currently no eligible banks to invest in either country as per the Link Asset Services weekly list

TREASURY MANAGEMENT SCHEME OF DELEGATION

The roles of the various bodies of the City of London Corporation with regard to treasury management are:

(i) Court of Common Council

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy.

(ii) Financial Investment Board and Finance Committee

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Receiving and reviewing regular monitoring reports and acting on recommendations
- Approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit & Risk Management Committee

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The Chamberlain

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit, and liaising with external audit
- Recommending the appointment of external service providers.

CITY'S CASH BORROWING POLICY STATEMENT

1. The City Corporation shall ensure that all of its City's Cash capital expenditure, investments and borrowing decisions are prudent and sustainable. In doing so, it will take into account its arrangements for the repayment of debt and consideration of risk and the impact, and potential impact, on the overall fiscal sustainability of City's Cash.

2. Borrowing shall be undertaken on an affordable basis and total capital investment must remain within sustainable limits. When assessing the affordability of its City's Cash investment plans, the City Corporation will consider both the City's Cash resources currently available and its estimated future resources, together with the totality of its City's Cash capital plans, income and expenditure forecasts.

3. To ensure that the benefits of capital expenditure are matched against the costs, a debt financing reserve will be established.

4. To the greatest extent possible, expected finance costs arising from borrowing are matched against appropriate revenue income streams.

5. The City Corporation will organise its borrowing on behalf of City's Cash in such a way as to ensure that financing is available when required to manage liquidity risk (i.e. to make sure that funds are in place to meet payments for capital expenditure on a timely basis). The City Corporation will only borrow in advance of need on behalf of City's Cash on the basis of a sound financial case (for instance, to mitigate exposure to rising interest rates).

6. The City Corporation will ensure debt is appropriately profiled to mitigate refinancing risk.

7. The City Corporation will monitor the sensitivity of liabilities to inflation and will manage inflation risks in the context of the inflation exposures across City's Cash (e.g. the City Corporation will be mindful of the potential impact of index-linked borrowing on the financial position of City's Cash).

8. The City Corporation will seek to obtain value for money in identifying appropriate borrowing for City's Cash. Where internal borrowing (i.e. from City Fund or Bridge House Estates) is used as a source of funding, the City Corporation will keep under review the elevated risk of refinancing.

9. All borrowing is expected to be drawn in Sterling. Where debt is raised in foreign currencies, the City Corporation will consider suitable measures for mitigating the risks presented by fluctuation in exchange rates.

10. Interest rate movement exposure will be managed prudently, balancing cost against likely financial impact.

11. The City Corporation will maintain the following indicators which relate to City's Cash borrowing only:

- Estimates of financing costs to net revenue stream
- Overall borrowing limits