

Committee: Financial Investment Board Audit and Risk Management Committee	Date: 29 November 2019 28 January 2020
Subject: Mid-Year Treasury Management Review 2019/20	Public
Report of: The Chamberlain	For Information
Report author: James Graham – Chamberlain’s Dept.	

Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2019/20 was approved by the Financial Investment Board and the Finance Committee in February 2019 and by the Court of Common Council on 7 March 2019 and came into effect on 1 April 2019.

Under CIPFA’s Code of Practice on Treasury Management, which was adopted by the Court of Common Council on 3 March 2010, there is a requirement to provide a mid-year review. The main points to note are as follows:

- As at 30 September 2019, the City had cash balances totalling £1,049.7m. Most of the balances are held for payment to third parties or are restricted reserves.
- No approved counterparty limits were breached during the first half of 2019/20 and the City has experienced no liquidity concerns.
- An additional £50m has been invested in the two short dated bond funds bringing the total investment in these vehicles to £150m.
- Long term market debt has been put in place on behalf of City’s Cash to support that entity’s capital expenditure plans.
- No external borrowing has been entered into by City Fund and it is not anticipated that City Fund will require any external borrowing during the remainder of the financial year.

Recommendation

Members are asked to note the report.

Main Report

Introduction

1. 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.
2. The second main function of the treasury management service is the funding of capital expenditure plans. During the first half of the year, the City concluded arrangements to put in place external borrowing on behalf of City's Cash, which will support that entity's long term capital financing plans. The City does not at this stage anticipate any external borrowing in the remainder of 2019/20 in respect of the City Fund.
3. The City's treasury management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017) which was adopted by the Court of Common Council on 3 March 2010.
4. 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 transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Treasury Management Strategy Statement and Annual Investment Strategy Update

5. The Treasury Management Strategy Statement and Annual Investment Strategy for 2019/20 was approved by the Financial Investment Board (12 February 2019), the Finance Committee (19 February 2019) and the Court of Common Council (7 March 2019).
6. There are no recommended policy changes to the Treasury Management Strategy.

Investment Portfolio

7. It is the City's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with its risk appetite. The pace of increases to the Bank of England's base rate remains the key determinant driving returns in the UK sterling money markets. The Bank's Monetary Policy Committee has left base rates unchanged at 0.75% for the first six months of the year. Interest rates remain at historic lows compared to the previous decade and this situation continues to depress the City's investment income.

8. The City held £1,049.7m of investments as at 30 September 2019 (£865.9m at 31 March 2019). Most of the balances are held for payment to third parties or are restricted reserves. The City has also taken receipt of borrowing proceeds during first half of the year (see below). The average rate of return on the City's treasury management portfolio at the end of September was 1.38%.
9. No approved counterparty limits were breached during the first half of 2019/20 and the City has experienced no liquidity concerns. The Treasury Management Strategy remains appropriate in enabling the City to pursue its prime objectives of security and liquidity, followed by yield.
10. The treasury portfolio includes investments in two short dated bond funds managed by Legal and General and Royal London Asset Management, respectively. At its meeting of 20 May 2019, the Financial Investment Board agreed to increase the investments from £50m each to £75m each (i.e. £150m in combination). Officers implemented this instruction on 5 June 2019.

Borrowing Strategy

City Fund

11. The City Fund has not acquired any external borrowing in the first half of the year and it is not anticipated that any external borrowing will be required in the remainder of 2019/20.
12. Historically, the principal source of external borrowing for UK local authorities has been the Public Works Loan Board, an agency of HM Treasury. The PWLB provides variable and fixed rate loans to qualifying authorities at a margin above Gilt rates. On 9 October, the PWLB increased the 80bps margin on Gilt rates that local authorities pay by 100bps with immediate effect (i.e. to Gilts plus 180bps). This is the "Certainty Rate", available to qualifying local authorities, including the City of London. HM Treasury has stated that this action has been taken to restore the borrowing rates to the levels available in 2018 (when Gilt rates were higher). Whilst this will have no immediate impact on the City's borrowing costs, it will inevitably make any future external borrowing via the PWLB more expensive. In time, the change may increase the diversity of borrowing sources available to local authorities.

City's Cash

13. The Treasury Management Strategy Statement 2019/20 stated that City's Cash expenditure plans created a borrowing requirement of £125.0m in 2018/19 rising to an estimated £428.4m in 2021/22. The City concluded arrangements for £450m new fixed rate market debt in July 2019 which eliminated a significant amount of interest rate risk exposure surrounding this borrowing requirement.
14. The first £250m tranche of borrowing proceeds of £250m were received on 11 September 2019. Half of this sum was immediately used to repay £125m short term borrowing on 16 September 2019 that had been secured in March 2019 to

support the City's Cash capital programme whilst longer term debt was being arranged.

15. The remaining £200m of borrowing proceeds will be received in July 2021 and will be used to support the planned increase in capital expenditure arising over the course of the next few years. By deferring receipt of this borrowing until 2021, the City has avoided paying additional interest costs whilst at the same time securing fixed rate borrowing on competitive terms. Likewise, by arranging both tranches of borrowing (the initial £250m and the deferred £200m) at once, the City has avoided the administrative and financial burden of running a second private placement process in 2021.

Economic Review

16. UK economic growth has been relatively volatile so far in 2019. The domestic economy expanded by 0.5% in Q1 2019 (in part due to companies increasing inventories ahead of the original Brexit date in March) but contracted by -0.2% in Q2 before making a modest rebound (0.3%) in Q3. Uncertainty has continued to weigh on business investments, although consumer spending has been resilient, supported by real increases in household income. The outlook for the global economy has softened over the first six months of the 2019-20 with the IMF's World Economic Outlook for October highlighting a global manufacturing downturn and rising trade barriers as salient factors. The IMF has downgraded its forecast for global growth from 3.3% to 3.0% for 2019, its lowest level since 2008-09.
17. The Bank of England's Monetary Policy Committee (MPC) met on 6 November and agreed to maintain Bank Rate at 0.75% by a vote of 7 – 2. The Bank of England's November Monetary Policy Report noted that, looking through the volatility, UK growth had slowed in 2019 and that this was in part due to a global slowdown reducing demand for UK goods and services abroad. The Bank's economic outlook projects UK growth to be around 1.25% in both 2019 and 2020, 1.75% in 2021 and 2.0% in 2022.
18. The Bank also stated that inflation is likely to fall in 2020 before gradually rising to just above the 2% target over the medium term. The UK economy continues to be affected by uncertainty over Brexit, although with the risk of a "no-deal" Brexit falling recently, the MPC expects uncertainty to dissipate somewhat. If this happens and if global growth recovers, as the Bank expects, the MPC may bring about a modest increase in interest rates to prevent prices from rising too quickly. However, if uncertainty and a synchronised global slowdown persist, the Bank could lower interest rates to support UK growth and return inflation to target.
19. Following the Bank of England's meeting in November, the City's treasury management advisors, Link, have revised their forecasts for UK interest rates and now expect the Bank of England to increase Bank Rate to 1.00% in Q1 2021, and to 1.25% in Q2 2021. Link contend that the Bank is unlikely to tighten monetary policy whilst there is still uncertainty around Brexit and that the path of interest rate changes will be heavily contingent upon economic and political developments.

Conclusion

20. The City has effectively executed the 2019/20 Treasury Management Strategy during the first six months of the year. The investment strategy remains appropriate for the second half of the year.

James Graham

Group Accountant – Pensions & Treasury Management

T: 020 7332 1137

E: James.Graham@cityoflondon.gov.uk