

Committee: Financial Investment Board	Dated: 30 November 2021
Subject: Treasury Management Update as at 31 October 2021	Public
Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?	All
Does this proposal require extra revenue and/or capital spending?	No
If so, how much?	£N/A
What is the source of Funding?	N/A
Has this Funding Source been agreed with the Chamberlain's Department?	N/A
Report of: The Chamberlain	For Information
Report author: James Graham – Chamberlain's Department	

Summary

This report provides a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 October 2021. The report includes an update on the current asset allocation of the short term investment portfolio and its performance and also includes the latest cash flow forecast (unchanged from the version reviewed by the Board in September). A monthly investment review report produced by the Corporation's treasury management consultants, Link Asset Services, is included at Appendix 2.

Since the Board last reviewed the treasury position the outlook on interest rates has evolved, with markets now expecting the Bank of England to raise base rates in the coming months. This has allowed the Corporation to obtain higher yields through an increased allocation to fixed term deposits. Officers expect interest income to increase further over the course of 2022 if the expected tightening in monetary policy materialises. The value of the Corporation's short-dated bond fund investments has declined marginally in the reporting period as market rates have increased. These investments remain appropriate for surplus cash balances that can be invested sustainably over the medium term given the expectation for higher returns over this time horizon.

Recommendation

Members are asked to note the report.

Main Report

Background

1. The Financial Investment Board receives an update on the treasury management portfolio at each meeting. Officers have compiled this report to provide additional context to the short-term investment portfolio as at 31 October 2021.

Current Position

2. The treasury management investment portfolio had a market value of £1,219.2m as at 31 October 2021, which is largely unchanged from the balance reported previously as at 31 July 2021 (£1,222.6m).

Asset Allocation

3. In accordance with the Treasury Management Strategy Statement 2021/22, surplus cash is invested first and foremost with the aim of securing the Corporation's financial assets and secondly in line with the organisation's liquidity requirements (i.e. ensuring the cash is available when needed to meet the Corporation's spending obligations). Once these two objectives have been satisfied, the Corporation targets the best returns available in the sterling money markets.
4. A summary of the asset allocation by instrument type as at 31 October 2021 compared to the position previously reported to the Board is displayed in table 1.

Table 1: Asset allocation as at 31 October 2021

	31-Jul-2021		31-Oct-2021	
	£m	%	£m	%
Fixed Term Deposit	335.0	27%	435.0	36%
Notice accounts	310.0	25%	310.0	26%
Short Dated Bond Funds	162.5	13%	160.9	13%
Ultra Short Dated Bond Funds	137.7	11%	137.5	11%
Liquidity Fund	277.5	23%	175.8	14%
Total	1,222.6	100%	1,219.2	100%

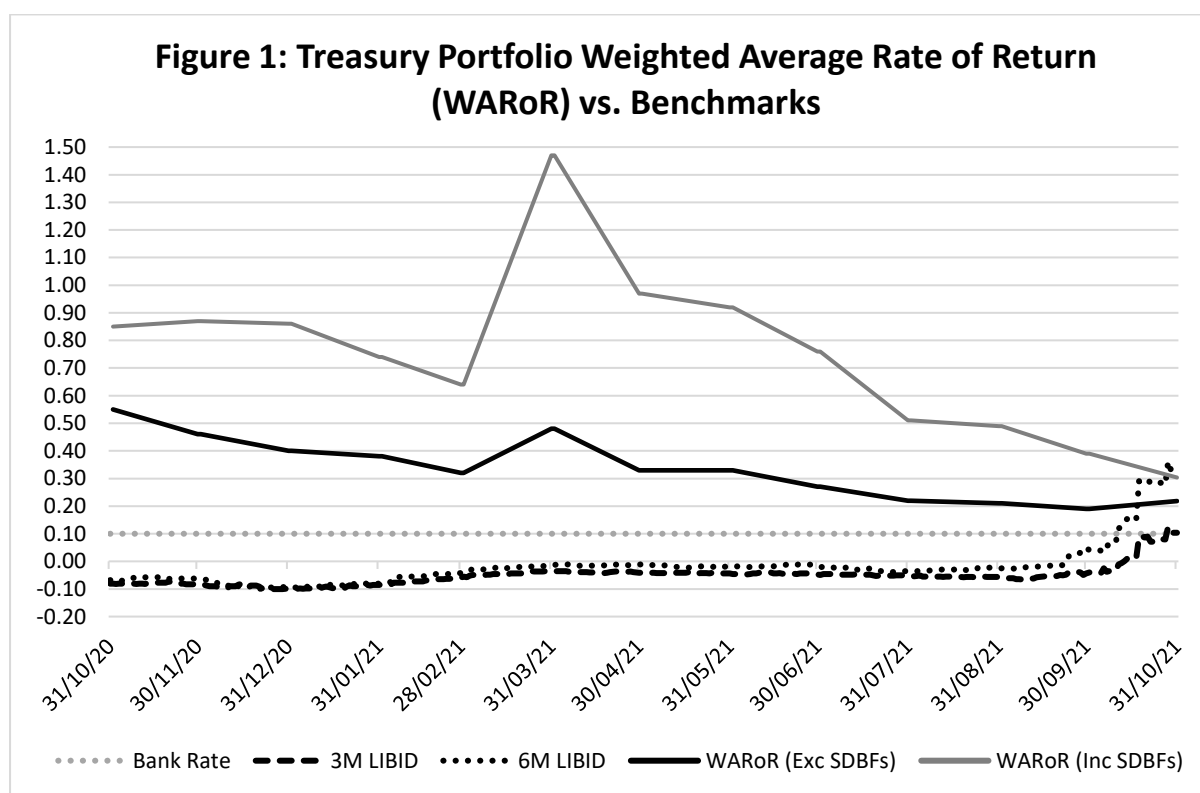
5. As at 31 October 2021, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks, building societies and local authorities via fixed term deposits (36%) and notice accounts (26%). The allocation to fixed term deposits has increased by £100m over the three months since July as the Corporation has been able to take advantage of higher rates available in the sterling money markets (see figure 1 below and paragraph 9). The increase has been funded via redemptions from lower yielding liquidity funds, which now make up around 14% of the portfolio. These balances are very liquid and can be accessed on the day.
6. 11% is invested in ultra-short dated bond funds. These instruments are also very liquid (funds can be redeemed with two to three days' notice) but their market value is more volatile than liquidity funds. Ultra-short dated bond funds are suitable for surplus cash balances with an investment horizon of six months or more. The remaining portion of the portfolio (13%) continues to be invested in short dated bond funds. These funds are invested in investment grade credit instruments and currently have a duration (weighted average time to maturity) of around 3 years. The value of the short dated bond funds can be volatile in the

short term and should only be used for surplus cash balances with an investment horizon of three years.

7. Further analysis on the composition of the portfolio as at 31 October 2021 is provided in the Monthly Investment Report at Appendix 2. A summary of counterparty exposure is also included at Appendix 1.

Performance

8. The weighted average rate of return for the portfolio over the past 12 months is shown in figure 1 below. In this chart, the solid lines represent the level of returns achieved by the Corporation while the “dashed” lines represent suitable performance comparators.



9. Sterling money market rates had been relatively stable for most of 2021 but rose sharply during September and October as shown in figure 1 via the readings for 3-month and 6-month London Interbank Bid Rate (LIBID). This change has been driven by mounting expectations that the Bank of England will be going to raise interest rates in the near future to manage inflation. Notwithstanding the change in sentiment, rates remain low by historical standards and below pre-pandemic levels.
10. Returns on the Corporation's short term investment portfolio have trended downwards over much of the year as existing, higher yielding deposits have matured and been replaced with new investments at a lower yield. This is visible in the weighted average return excluding short dated bond funds above (which omits the two longer-term short dated bond fund investments in the portfolio). The downward trend was partially reversed in October as the Corporation capitalised

on an increase in rates. If monetary policy is gradually tightened over the course of 2022 then officers expect this rate of return to steadily increase from current levels.

11. Given the evolving outlook for interest rates, officers have reviewed the competitiveness of the current notice accounts and taken action (i.e. given notice or requested a rate uplift) where appropriate.
12. As month-to-month returns from the ultra-short and short dated bond fund investments can be volatile, for these instruments, officers have used the trailing 12 month total return to 31 October 2021 in calculating the portfolio returns displayed in figure 1. Returns on these investments have slowed over the last six months (as shown in the weighted average rate of return including short dated bond funds in figure 1) as the effects of the strong recovery in mid-2020 have dropped out of the calculation.
13. To aid an effective assessment of performance, table 2 shows the historical return of the ultra-short and short dated bond fund investments on a total return basis over various time horizons under one year.

Table 2: Bond Fund Total Returns as at 31 October 2021

Fund	1 Month Return (30/09/2021 to 31/10/2021)	3 Month Return (31/07/2021 to 31/10/2021)	12 Month Return (31/10/2020 to 31/10/2021)
Federated Hermes Sterling Cash Plus Fund	-0.05%	-0.03%	0.01%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	-0.01%	0.02%	0.17%
Payden Sterling Reserve Fund	-0.16%	-0.26%	0.08%
L&G Short Dated Sterling Corporate Bond Index Fund	-0.60%	-1.01%	0.59%
Royal London Investment Grade Short Dated Credit Fund	-0.55%	-0.89%	1.14%

14. The most conservative fund (Federated) is listed first in table 2 and the longer term investments (L&G and Royal London) are listed at the bottom to the table.
15. The increase in interest rates has had a negative effect on short term performance, although this has occurred after a sustained period of price appreciation, as evidenced by the fact that all funds have produced positive returns over the year to the end of October 2021.
16. As noted above, the capital values of the bond funds – particularly the short-dated bond funds – can be volatile over the short term but they are expected to produce higher returns over the longer term: over the past three years the L&G and Royal London bond funds have generated annualised returns of 2.55% and 3.62%,

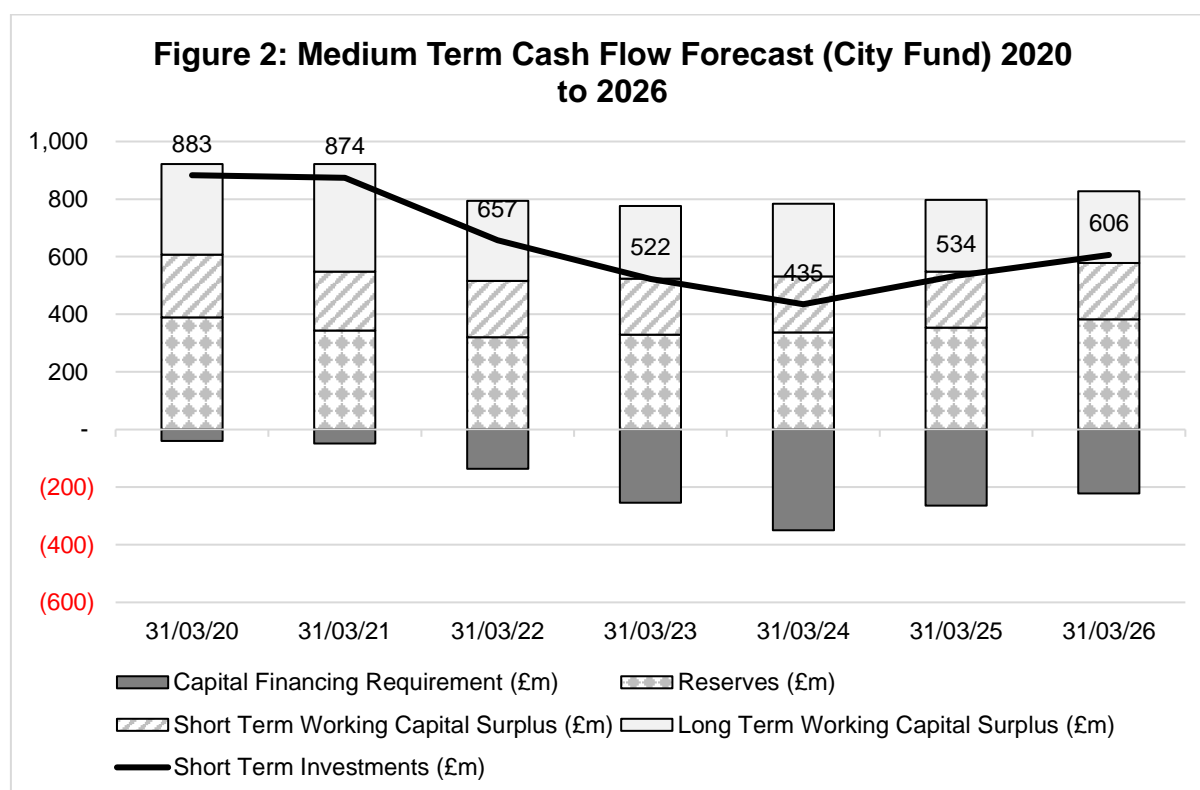
respectively. The Corporation deliberately allocates a small portion of the overall portfolio to these investments - an amount that can sustainably be invested over the medium term.

17. It should also be noted that fluctuations in the market value of investments do not impact the City Fund's revenue position owing to the existence of the IFRS 9 statutory override which English local authorities are required to implement.

Cash Flow Forecast

18. The City Fund's medium-term cash flow forecast is shown below in figure 2. City Fund's cash investments amount to £874m as at 31 March 2021, or 92% of the total cash under management in the treasury portfolio at that time. The remainder belongs to City's Cash (1%), Bridge House Estates (3%) and other bodies (4%).

19. Cash investments (represented by the black line in figure 3) are expected to be below historic levels over the next few years before recovering towards the end of the forecast period.



20. The forecast is unchanged from the projection reported to the Board at its last meeting on 14 September. The forecast will continue to be reviewed by officers in tandem with the medium term financial planning process.

21. While this forecast is based on the City Fund's current financial plans it includes several assumptions and it is unlikely that actual cash balances will materialise exactly as forecast. In particular, Members should note the following:

- Historically planned capital expenditure has been subject to re-profiling (“slippage”). If the City Fund’s current capital spending plans are re-profiled during the forecast period then the forecast will shift to the right.
- The forecast will need to be continually updated in line with the medium-term financial planning process and the Corporation’s financial decisions.
- Officers also expect to make methodological improvements to the forecast calculation to improve its accuracy.

22. In terms of the key financial assumptions implicit in the forecast, Members may observe that the critical factor driving the forecast is the pace at which the City Fund’s capital spending plans are progressed. The forecast assumes spending on the major projects programme (City Fund components) will increase in intensity over the next few years and be substantively complete by the end of 2025/26. The forecast assumes the programme will be funded in the main by a mixture of capital receipts, grant funding, fundraising and internal borrowing (i.e. no external borrowing is assumed).

Conclusion

23. This report has provided a summary of the City of London Corporation’s treasury management portfolio (investments) as at 31 October 2021. Cash is invested across a range of counterparties and instruments in accordance with the Corporation’s Treasury Management Strategy Statement 2021/22.

24. Since the Board last reviewed the treasury position the outlook on interest rates has evolved, with markets now expecting the Bank of England to raise base rates in the coming months. This has allowed the Corporation to obtain higher yields through an increased allocation to fixed term deposits. Officers expect interest income to increase further over the course of 2022 if the expected tightening in monetary policy materialises. The value of the Corporation’s short-dated bond fund investments has declined marginally in the reporting period as market rates have increased. These investments remain appropriate for surplus cash balances that can be invested sustainably over the medium term given the expectation for higher returns over this time horizon.

Appendices

Appendix 1: Counterparty Exposure as at 31 October 2021

Appendix 2: Monthly Investment Analysis Review October 2021

Background Papers

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APPENDIX 1: COUNTERPARTY EXPOSURE AS AT 31 OCTOBER 2021

	Counterparty Limit £M	Total Invested as at 31-Oct-21 £M	Average Rate of Return %
<u>TOTAL INVESTED</u>	-	<u>1,219.2</u>	<u>0.30%</u>
<u>FIXED TERM DEPOSITS</u>	-	-	
- <u>UK BANKS</u>			
Barclays	100.0	50.0	0.33%
Goldman Sachs	100.0	20.0	0.13%
Lloyds	150.0	40.0	0.10%
NatWest	100.0	100.0	0.23%
		<u>210.0</u>	
<u>BUILDING SOCIETIES</u>			
Leeds	20.0	20.0	0.14%
Nationwide	120.0	40.0	0.09%
		<u>60.0</u>	
<u>FOREIGN BANKS</u>			
Australia & New Zealand	100.0	10.0	0.12%
Helaba	100.0	100.0	0.30%
National Australia Bank	100.0	45.0	0.49%
		<u>155.0</u>	
<u>LOCAL AUTHORITIES</u>			
Stockport City Council	25.0	10.0	0.10%
		<u>10.0</u>	
<u>LIQUIDITY FUNDS</u>			
Aberdeen SLI Liquidity Fund	100.0	4.2	0.01%
CCLA - Public Sector Deposit Fund	100.0	54.4	0.03%
Deutsche Global Liquidity Fund	100.0	42.2	0.02%
Federated Prime Liquidity Fund	100.0	24.3	0.01%
Invesco Sterling Liquidity Fund	100.0	50.7	0.02%
		<u>175.8</u>	
<u>ULTRA SHORT DATED BOND FUNDS</u>			
Payden Sterling Reserve Fund	100.0	61.8	0.08%
Aberdeen SLI Short Duration Fund	100.0	50.4	0.17%
Federated Sterling Cash Plus Fund	100.0	25.3	0.01%
		<u>137.5</u>	
<u>SHORT DATED BOND FUNDS</u>			
L&G	100.0	80.4	0.59%
Royal London	100.0	80.5	1.14%
		<u>160.9</u>	

	Counter- party Limit	Total Invested as at 31-Oct-21	Average Rate of Return
	£M	£M	%
<u>NOTICE ACCOUNTS</u>			
Australia and New Zealand 185 Days Account	100.0	90.0	0.28%
Goldman Sachs 185 Days Account	100.0	20.0	0.24%
Goldman Sachs 185 Days Account	100.0	20.0	0.23%
Goldman Sachs 185 Days Account	100.0	20.0	0.23%
Goldman Sachs 270 Days Account	100.0	20.0	0.33%
Lloyds 95 Days Account	150.0	40.0	0.05%
Santander 95 Days Account	100.0	20.0	0.40%
Santander 180 Days Account	100.0	30.0	0.58%
Santander 365 Days Account	100.0	50.0	0.68%
		<u>310.0</u>	
<u>TOTAL</u>		<u><u>1,219.2</u></u>	