Committee: Financial Investment Board Audit and Risk Management Committee	**Dated:** 30 November 2021 18 January 2022
Subject: Mid-Year Treasury Management Review 2021/22	**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**
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Summary

The Treasury Management Strategy Statement and Annual Investment Strategy for 2021/22 was approved by the Financial Investment Board and the Finance Committee in February 2021 and by the Court of Common Council on 4 March 2021 and came into effect on 1 April 2021.

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:

- The strategy has been reviewed to take account of economic and market developments over the first half of the year, particularly with regard to changes in interest rate expectations.
- The revised path for interest rates over the medium term provided by Link Asset Services now involves a steeper trajectory for interest rates: the forecast projects a first increase in Bank Rate to 0.25% by the end of the calendar year 2021 followed by successive incremental increases over the coming years leaving Bank Rate at around 1.25% at the end of 2024/25 (see Appendix).
- Under this scenario of modest increases, investment returns are still expected to remain very low relative to historical standards, albeit marginally higher than anticipated at the start of the year. Despite the very low returns available on cash investments at present, the Corporation's priorities remain as security and liquidity (ahead of yield). Given the current risk environment, officers do not recommend that the Corporation relaxes its risk appetite for the second half of the year.
- As at 30 September 2021, the City had cash balances totalling £1,223.4m. Most of the balances are held for payment to third parties or are restricted reserves. Cash balances are expected to reduce meaningfully over the medium term as spending on the capital programme increases.
- No approved counterparty limits were breached during the first half of 2021/22 and the City has experienced no liquidity concerns.

- 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. In September 2019 the City issued fixed rate market debt on behalf of City's Cash via a private placement, which will support that entity's long term capital financing plans. The first tranche of borrowing proceeds of £250M were received in September 2019. The second tranche of borrowing proceeds of £200M were received in July 2021. The City has not undertaken any new borrowing in the first half of this year and does not at this stage anticipate any external borrowing in the remainder of 2021/22.

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.

Economic Update

5. Quarterly growth in the UK economy was +5.5% in Q2 2021 (April to June) and is estimated to have slowed to +1.3% in Q3 (July to September). In common with other economies around the globe re-opening from lockdowns, the pace of recovery has been hampered by supply shortages which has led to price increases across goods, services, fuel and labour. For most of the year the Bank of England's Monetary Policy Committee (MPC) emphasised the transitory nature of this inflation, expecting price rises to dissipate once the economy automatically readjusted. However, at its September meeting, in a marked shift

in tone, the MPC noted that some tightening in monetary policy was now on the horizon which would be needed to bring inflation to the 2% target over the medium term. In response, markets began to price in an immediate increase in rates ahead of the MPC's next meeting in November.

6. In reality, when the MPC met on 2nd November it voted by to 7-2 to maintain Bank Rate at 0.10%. The Bank noted some softening in consumer demand and also observed the unusual uncertainty around the outlook for the labour market given that the Government's furlough scheme had only recently been brought to a close. The central bank faces a difficult balancing act as it needs to control inflation but also avoid smothering recovering GDP by raising interest rates too soon.

7. Longer term interest rates, represented by gilt yields (from which PWLB rates are priced), have been relatively volatile over the course of 2021 to date. During September, gilt yields from 5 – 50 years rose following the relatively hawkish tone of the MPC's minutes on 23rd September. Gilt yields then fell sharply after the UK Government's Budget on 27th October cancelled nearly all gilt sales until the end of the financial year.

8. The Corporation's treasury consultants, Link Asset Services, have provided an updated interest rate forecast which is attached as an Appendix. Considering the above, officers expect that the Bank will now start to tighten monetary policy and raise interest rates earlier than expected at the start of the year. The forecasts also include a steady, but slow, rise in gilt yields during the forecast period to March 2025.

Treasury Management Strategy Statement and Annual Investment Strategy Update

9. The Treasury Management Strategy Statement and Annual Investment Strategy for 2021/22 was approved by the Financial Investment Board (9 February 2021), the Finance Committee (16 February 2021) and the Court of Common Council (4 March 2021).

10. Having considered the strategy, officers believe that it remains appropriate for the second half of 2021/22 and do not recommend any fundamental changes are made.

<u>Investment Strategy</u>

11. The Corporation held £1,223.4m of investments as at 30 September 2021 (£947.1m at 31 March 2021). Most of the balances are held for payment to third parties or are restricted reserves; they also include debt issued by City's Cash in 2019/20 and in the first half of 2021/22 which is yet to be applied to capital spending). As the Corporation's capital programme progresses, cash balances are projected to decline as internal borrowing increases (see paragraph 20 below). The weighted average rate of return on the City's treasury management portfolio at the end of September was 0.39%.

12. In accordance with the CIPFA Treasury Management Code of Practice, the Corporation's investment priorities are:

- Security of capital
- Liquidity
- Yield

13. The Corporation aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Corporation's risk appetite. In the current economic climate, it is considered appropriate to retain sufficient capacity to cover planned and potentially unanticipated cash flow needs, but also to seek out value by placing deposits with high credit rated counterparties where possible. The current investment strategy remains appropriate for facilitating these aims by limiting lending to only high-quality borrowers whilst also not being so restrictive as to create an overconcentration of exposure to any single counterparty.

14. Over the last decade interest rates have been grounded at historically low levels, with the Bank Rate currently set at 0.10%. At the outset of the year, the Corporation estimated modest increases in short term interest rates over the medium term. Since the original strategy was written, economic developments domestically and globally particularly concerning inflation, have raised expectations that central banks (including the Bank of England) will have to raise policy rates earlier than previously expected (see above).

15. Consequently the revised path for interest rates over the medium term provided by Link Asset Services now involves a steeper trajectory for interest rates. The forecast projects a first increase in Bank Rate to 0.25% by the end of the calendar year followed by successive incremental increases over the coming years leaving Bank Rate at around 1.25% at the end of 2024/25 (see Appendix). Under this scenario of modest increases, investment returns are still expected to remain very low relative to historical standards, albeit marginally higher than anticipated at the start of the year.

16. The actual path of interest rates over the coming years could deviate markedly from this central expectation, which is subject to a high level of uncertainty. Key risks to the forecast are as follows:

    - Slowing economic growth (this could create a stagflation type dilemma for the Bank of England if inflation persists which would need to focus on either combating inflation or supporting economic growth by keeping rates low).
    - Whether or not supply shortages persist.
    - Rising energy prices limiting consumer spending.
    - Whether consumers are prepared to spend some of the £160bn of excess savings generated during the pandemic.
    - How the labour market evolves in the context of the end of the furlough scheme and labour supply shortages in various sectors.
    - Further mutations in the Covid virus.

17. Although the returns on cash investments are at historic lows, the prime objective is to ensure cash is safe and available when needed. It is not recommended that the Corporation relaxes its creditworthiness criteria at this stage to protect

income as this would contradict the primary obligation of keeping the Corporation's cash assets secure, before considering yield.

18. No approved counterparty limits were breached during the first half of 2021/22 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.

Borrowing Strategy

City Fund

19. 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 2021/22.

20. Although the City Fund is forecast to have a growing capital financing requirement forecast in the years ahead, it expects to be able to fund this in the short term via internal borrowing. Entering into new external borrowing now would increase the Corporation's revenue pressures in the immediate term (i.e. there would be a cost of carry). The outlook for interest rates indicates a slightly steeper path for borrowing costs over the years ahead compared to the position set out in the original strategy. Nonetheless given the substantial cash balances the organisation holds, officers recommend that no new borrowing is undertaken for now. Officers will continue to review this position in light of changing market conditions.

City's Cash

21. City's Cash issued £450m of market debt in 2019/20, £200m of which was deferred for receipt until 2021/22. The Corporation took receipt of these borrowing proceeds in July this year and they are currently held in the short term investments portfolio until required by the capital programme. By deferring receipt of this borrowing until 2021, the City avoided paying additional interest costs whilst at the same time securing fixed rate borrowing on competitive terms. There are no plans to undertake any further borrowing on behalf of City's Cash in the second half of the year.

Conclusion

22. The City has effectively executed the 2021/22 Treasury Management Strategy during the first six months of the year. After considering the original strategy against the current treasury management environment, officers judge that the investment strategy remains appropriate for the second half of the year.

APPENDIX: Interest Rate Forecasts 2021 - 2025

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APPENDIX: Interest Rate Forecasts 2021 – 2025

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Group Interest Rate View 8.11.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80	1.90	1.90	2.00	2.00
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30	2.40
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.70	2.70
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50

Bank Rate	NOW	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Link Group	0.10%	0.25%	0.25%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%
Capital Economics	0.10%	0.25%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	-

5yr PWLB Rate	NOW	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Link Group	1.41%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%
Capital Economics	1.41%	1.60%	1.70%	1.80%	1.90%	2.10%	2.10%	2.10%	2.10%	2.10%	-

10yr PWLB Rate	NOW	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Link Group	1.68%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%	2.10%	2.20%	2.20%	2.20%
Capital Economics	1.68%	1.80%	2.00%	2.10%	2.20%	2.30%	2.30%	2.30%	2.30%	2.30%	-

25yr PWLB Rate	NOW	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Link Group	1.90%	2.10%	2.20%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
Capital Economics	1.90%	2.10%	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.80%	2.90%	-

50yr PWLB Rate	NOW	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Link Group	1.63%	1.90%	2.00%	2.10%	2.20%	2.20%	2.20%	2.30%	2.30%	2.40%	2.40%
Capital Economics	1.63%	1.90%	2.10%	2.30%	2.40%	2.60%	2.60%	2.70%	2.70%	2.70%	-