

<b>Committee:</b> Financial Investment Board	<b>Dated:</b> 14 October 2022
<b>Subject:</b> Treasury Management Update as at 31 July 2022	<b>Public</b>
<b>Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?</b>	<b>All</b>
<b>Does this proposal require extra revenue and/or capital spending?</b>	<b>No</b>
<b>If so, how much?</b>	<b>£N/A</b>
<b>What is the source of Funding?</b>	<b>N/A</b>
<b>Has this Funding Source been agreed with the Chamberlain's Department?</b>	<b>N/A</b>
<b>Report of:</b> The Chamberlain	<b>For Discussion/ Information</b>
<b>Report author:</b> Kate Limna – Chamberlain's Department	

### Summary

This report provides a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 July 2022. The report includes an update on the current asset allocation of the short term investment portfolio and its performance. A monthly investment review report produced by the Corporation's treasury management consultants, Link Asset Services, is included at Appendix 2.

Interest rates have continued to rise significantly since the Board last reviewed the treasury position as the Bank of England's Monetary Policy Committee has hiked its policy rate at the last three consecutive meetings since March from 0.75% to 1.75%. Markets forecast Bank Rate to peak at 2.75% by March 2023. The increase in rates has allowed the Corporation to obtain higher yields through its allocation to fixed term deposits. Officers expect interest income to increase further over the course of 2022/23 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. They also continue to generate strong income returns.

### 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 July 2022.

### Current Position

2. The treasury management investment portfolio had a market value of £1,298.4m as at 31 July 2022, which represents an increase of £72.4m versus balance reported previously as at 31 March 2022 (£1,226.0m). Historically, the Corporation has experienced higher cash balances at the start of the financial year compared to the end of the prior year due to the profile of business rates income received by the City Fund.

### Asset Allocation

3. In accordance with the Treasury Management Strategy Statement, 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 July 2022 compared to the position previously reported to the Board is displayed in table 1.

**Table 1: Asset allocation as at 31 July 2022**

	31-Mar-2022		31-Jul-2022	
	£m	£m	£m	%
Fixed Term Deposit	535.0	44%	585.0	45%
Notice accounts	270.0	22%	220.0	17%
Short Dated Bond Funds	156.4	13%	153.7	12%
Ultra Short Dated Bond Funds	137.1	11%	137.2	10%
Liquidity Fund	127.5	10%	202.5	16%
<b>Total</b>	<b>1,226.0</b>	<b>100%</b>	<b>1,298.4</b>	<b>100%</b>

5. As at 31 July 2022, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks and building societies via fixed term deposits (45%) and notice accounts (17%). The allocation to fixed term deposits has increased over the four months since March as the Corporation has taken advantage of higher rates available in the sterling money markets (see figure 1 below and paragraph 9). Liquidity funds now make up around 16% of the portfolio. These balances are very liquid and can be

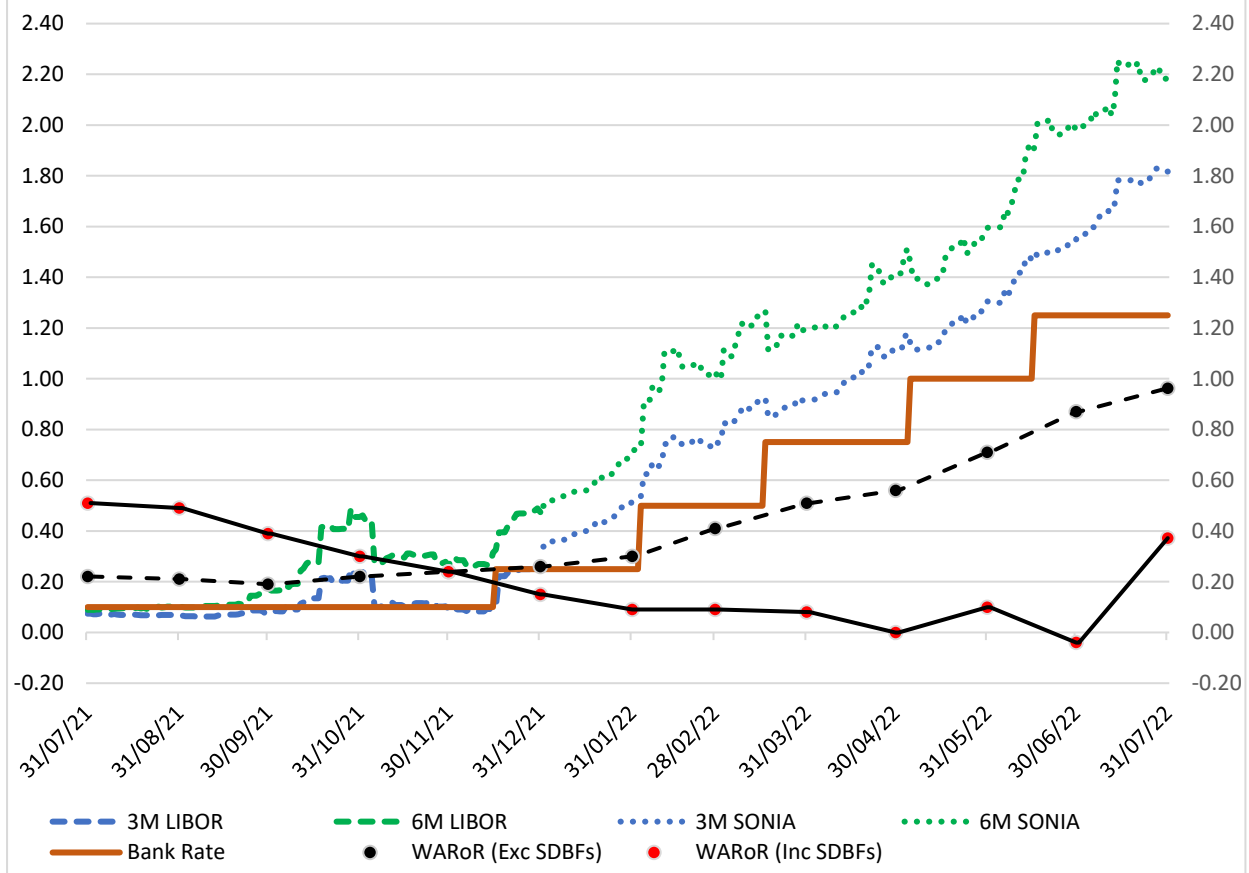
accessed on the day. As the fixed term deposits mature, the intention is to reinvest these.

6. 10% 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 (12%) 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 at least three years (the average duration).
7. Further analysis on the composition of the portfolio as at 31 July 2022 is provided in the Monthly Investment Report at Appendix 2. A summary of counterparty exposure is also included at Appendix 1.

### Performance

8. Since March 2022, the Bank of England has continued to increase its policy rate, Bank Rate, from 0.75% to 1.75% in successive moves each month. Earlier this month the Bank of England confirmed it expected inflation to reach 13% by the end of the year with the upside shift reflecting rising energy prices. The tightening in monetary policy is deemed necessary by the Bank to bring inflation back down towards its 2% target over the medium term, indicating further interest rate increases are likely over the coming months. Markets predict Bank Rate will peak at 2.75% by March 2023 where it will remain for the rest of the year until 2023. It will start to fall and begin decreasing in 2024. As Bank Rate is the primary determinant of short-term interest rates in the UK, these changes have impacted the treasury investment portfolio, broadly in two ways:
  - a. As yields have increased, the capital value of the Corporation's bond fund investments has declined, which has reduced their total returns as at the reporting date. These investments are exposed to interest rate risk which the Corporation manages by ensuring the allocations are consistent with a longer term investment horizon for this minority portion of the portfolio.
  - b. For the majority of the portfolio – which is invested in short term money market instruments – the increase in interest rates means that the Corporation can benefit from materially enhanced returns on new deposits and via the shorter term liquidity funds.
9. These effects can be seen in the weighted average rate of return for the portfolio over the past 12 months, as 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.

**Figure 1: Treasury Portfolio Weighted Average Rate of Return (WARoR) vs. Benchmarks**



10. Returns on the Corporation's short term investment portfolio excluding the short dated bond funds (represented by the dashed black line in figure 1) continue to trend upwards as existing, lower yielding deposits have been replaced with new investments at higher yields. This portion of the portfolio also includes the very short term liquidity fund investments whose yields respond quickly to changes in Bank Rate and have thus increased from around 0.50% to over 1.50% since the last meeting. If monetary policy is tightened further over the course of 2022, then officers expect this rate of return to continue to steadily increase from current levels.

11. 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 July 2022 in calculating the portfolio returns displayed in figure 1. Total returns on these investments have reduced over the quarter, which largely reflects the rotation to a rising interest rate environment.

<sup>1</sup> The LIBOR reference rate is in the process of being phased out and is no longer published as of 1 January 2022. From 1 January 2022, the portfolio is benchmarked against the Sterling Overnight Index Average (SONIA) reference rates.

12. 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 July 2022**

<b>Fund</b>	<b>1 Month Return (30/06/2022 to 31/07/2022)</b>	<b>3 Month Return (30/04/2021 to 31/07/2022)</b>	<b>12 Month Return (31/07/2021 to 31/07/2022)</b>
Federated Hermes Sterling Cash Plus Fund	0.10%	0.25%	0.29%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.12%	0.18%	0.23%
Payden Sterling Reserve Fund	0.45%	0.08%	-1.05%
L&G Short Dated Sterling Corporate Bond Index Fund	1.13%	-0.56%	-5.68%
Royal London Investment Grade Short Dated Credit Fund	1.74%	-0.59%	-5.10%

13. 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. The increase in interest rates has had a negative effect on these funds' total returns recently, although this has occurred after a sustained period of price appreciation prior to 2021/22.

14. 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 +0.45% and +0.18%, 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.

15. Notwithstanding the decline in capital values, the income yield on the bond funds with Royal London have increased over the quarter to 4.0% (gross of fees). The yield on L&G has weakened marginally to 2.0% (gross of fees) as at the end of July 2022.

16. 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, and which requires unrealised capital gains and losses to be charged to an unusable reserve on the balance sheet rather than reported via income and expenditure.

## Cash Flow Forecast

17. The City Fund's medium-term cash flow forecast is currently being reviewed as are all the capital projects. Once this has been completed an updated cash flow forecast will be provided.

## **Conclusion**

18. This report has provided a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 July 2022. Cash is invested across a range of counterparties and instruments in accordance with the Corporation's Treasury Management Strategy Statement.

19. Interest rates have continued to rise significantly since the Board last reviewed the treasury position as the Bank of England's Monetary Policy Committee has hiked its policy rate at the last three consecutive meetings since March from 0.75% to 1.75%. Markets forecast Bank Rate to peak at 2.75% by March 2023. The increase in rates has allowed the Corporation to obtain higher yields through its allocation to fixed term deposits. Officers expect interest income to increase further over the course of 2022/23 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. They also continue to generate strong income returns.

## **Appendices**

Appendix 1: Counterparty Exposure as at 31 July 2022

Appendix 2: Monthly Investment Analysis Review July 2022

## **Background Papers**

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**APPENDIX 1: COUNTERPARTY EXPOSURE AS AT 31 JULY 2022**

	<b>Counterparty Limit</b>	<b>Total Invested as at 31-Jul-22</b>	<b>Average Rate of Return</b>
	<b>£M</b>	<b>£M</b>	<b>%</b>
<b><u>TOTAL INVESTED</u></b>		<b><u>1,298.4</u></b>	<b><u>0.35%</u></b>
<b><u>FIXED TERM DEPOSITS</u></b>			
<b><u>UK BANKS</u></b>			
Barclays	100.0	45.0	0.94%
Goldman Sachs	100.0	60.0	1.79%
NatWest	100.0	80.0	0.77%
		<u>185.0</u>	
<b><u>BUILDING SOCIETIES</u></b>			
Leeds	20.0	20.0	2.09%
Yorkshire	20.0	20.0	0.55%
		<u>40.0</u>	
<b><u>FOREIGN BANKS</u></b>			
DBS	100.0	80.0	1.63%
Helaba	100.0	75.0	2.09%
National Australia Bank	100.0	85.0	1.00%
Toronto Dominion	100.0	100.0	1.25%
Rabobank	100.0	20.0	2.90%
		<u>360.0</u>	
<b><u>LIQUIDITY FUNDS</u></b>			
Aberdeen SLI Liquidity Fund	100.0	41.0	1.23%
CCLA - Public Sector Deposit Fund	100.0	38.9	1.23%
Deutsche Global Liquidity Fund	100.0	38.0	1.19%
Federated Prime Liquidity Fund	100.0	41.6	1.33%
Invesco Sterling Liquidity Fund	100.0	43.0	1.26%
		<u>202.5</u>	
<b><u>ULTRA SHORT DATED BOND FUNDS</u></b>			
Payden Sterling Reserve Fund	100.0	61.3	-1.05%
Aberdeen SLI Short Duration Fund	100.0	50.5	0.23%
Federated Sterling Cash Plus Fund	100.0	25.4	0.29%
		<u>137.2</u>	
<b><u>SHORT DATED BOND FUNDS</u></b>			
L&G	100.0	76.60	-5.68%
Royal London	100.0	77.1	-5.10%
		<u>153.7</u>	

	<b>Counterparty Limit</b>	<b>Total Invested as at 31-Jul-22</b>	<b>Average Rate of Return</b>
	<b>£M</b>	<b>£M</b>	<b>%</b>
<u>NOTICE ACCOUNTS</u>			
Australia and New Zealand 185 Days Account	100.0	90.0	1.43%
Goldman Sachs 185 Days Account	100.0	20.0	0.43%
Goldman Sachs 270 Days Account	100.0	10.0	0.53%
Santander 95 Days Account	100.0	20.0	1.05%
Santander 180 Days Account	100.0	30.0	0.95%
Santander 365 Days Account	100.0	50.0	1.15%
		<u>220.0</u>	
		<u>1,298.4</u>	
<u>TOTAL</u>		<u>1,298.4</u>	