Committee(s): Financial Investment Board Bridge House Estates Board Finance Committee	**Dated:** 13 September 2022 13 September 2022 20 September 2022
Subject: Treasury Management Strategy 2022/23 - Proposed Amendment	**Public**
Which outcomes in the City Corporation's Corporate Plan does this proposal aim to impact directly?	All
For BHE, which outcomes in the Bridging London Strategy does this proposal aim to impact?	1, 2 and 3
Does this proposal require extra revenue and/or capital spending?	**N/A**
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 Decision**
Report author: Kate Limna/James Graham, Chamberlain's Department	

Summary

This report proposes an amendment to the Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 (TMSS) to improve the alignment between the strategy and the various individual participants whose treasury management activities the TMSS applies to. The Bridge House Estates Board is asked to make a decision in respect of Bridge House Estates and the Financial Investment Board in respect of City's Cash and the smaller participants.

This proposed change, if agreed by the Bridge House Estates Board and the Financial Investment Board will need to be submitted to the Finance Committee and the Court of Common Council for formal adoption and the amendment to the 2022/23 TMSS would be applied retrospectively (i.e. backdated to 1 April 2022).

Recommendations

Financial Investment Board

i) Members are asked to note the report and to agree the amendment to the Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 set out at paragraphs 11-15 and Appendix 1.

Bridge House Estates Board

ii) Members of the Bridge House Estates Board are asked to note the report and agree the proposals in relation to Bridge House Estates set out at paragraph 15, noting the loss that would be realised as set out in paragraph 17.

Finance Committee

iii) Subject to the outcome of the above, the Finance Committee is asked to formally adopt the amendment to the Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 set out at paragraphs 11-15 and Appendix 1.

Main Report

Background

1. The Treasury Management Strategy Statement and Annual Investment Strategy (TMSS) for 2022/23 covers treasury management activity carried out across the organisation, including in respect of City Fund, City's Cash and Bridge House Estates, as well as some smaller participants. The TMSS defines 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.

2. A major function of the TMSS is to set out how the Corporation will manage its surplus cash balances, in pursuit of the optimum return on its investments once security and liquidity criteria have been satisfied.

3. In setting the TMSS and managing its treasury management arrangements, the City adheres to the requirements of the CIPFA Code of Practice on Treasury Management, which was originally adopted by the Court of Common Council on 2 March 2010.

4. The current TMSS (for the financial year 2022/23) was approved by the Financial Investment Board on 9 February 2022; by Bridge House Estates Board on 16 February 2022; Finance Committee on 15 February 2022; and by the Court of Common Council on 10 March 2022.

5. As at the 31 March 2022 the City's treasury management investments are valued at £1,226.0m. Most of these balances relate to City Fund (85%), followed by City's Cash (12%) and BHE (2%). The residual 1% belongs to smaller participants in the TMSS.

Current Position

6. As the TMSS principally refers to the organisation's treasury management activities in the aggregate, treasury management investment policy decisions are made with reference to the organisation's "global" circumstances. The principal benefit of this approach has been that it enables all participants in the TMSS to pool resources and obtain access to investments with higher expected returns. Specifically, the TMSS groups investments under two headings – specified and non-specified investments – which are defined within the TMSS as follows:

   - **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.

7. As at 31 March 2022, £156.4m (13%) of the Corporation's total treasury management investment portfolio is classified under non-specified investments. This allocation consists entirely of exposure to two short dated bond funds as shown below.

Short Dated Bond Fund Name	Original Principal	Market Value (31/03/2022)	Max Limit
L&G Short Dated Sterling Corporate Bond Index Fund	£75.0m	£78.0m	£100m
Royal London Investment Grade Short Dated Credit Fund	£75.0m	£78.4m	£100m

8. Non-specified investments are appropriate for investors who expect to maintain positive cash balances over a multi-year period and whilst this is expected to be the case for the City's overall cash position, officers recognise that there is scope to further optimise the TMSS so that it is better aligned with each and every individual participant's own particular circumstances.

9. By far the largest participant in the TMSS in terms of investment balances is City Fund. City Fund's investment balances are expected to endure for the foreseeable future, despite an anticipated decline over the medium term as the capital programme progresses and (as a consequence) the capital financing requirement increases. In contrast, cash balances relating to both Bridge House Estates and City's Cash are expected to decline to low levels over the medium term under the current plans for both funds. Moreover, some of the smaller participants in the TMSS maintain relatively small cash balances whose overall size can change quite markedly from one year to the next.

Options

10. Officers have identified three options for improving the current TMSS to better align with individual participants' circumstances:

    a. Option A – bifurcate the Annual Investment Strategy within the TMSS into two strategies: one for City Fund which includes exposure to the full range of investments (both specified and non-specified as defined in paragraph 6 above) permitted in the current TMSS and a second strategy for others which restricts exposure to specified investments only. This is officers' recommendation.

    b. Option B – develop and maintain an individual treasury management strategy for each participant. Officers do not consider this a realistic option as the governance resource implications of maintaining numerous portfolios and managing portfolio risks on an individual basis would likely exhaust any benefit.

    c. Option C – do nothing. Alternatively, the Corporation could continue to maintain a single investment strategy in the TMSS. Whilst this option is most straightforward operationally it does not address the varying risk tolerances that exist amongst the participants in the TMSS and therefore officers do not recommend this option is pursued.

Proposals

11. Under the recommended option (Option A), City Fund would maintain exposure to longer term investments. Optimising returns over the long term is an important consideration for the City Fund, which is projected to maintain sizeable cash balances over the foreseeable future. Non-specified investments are an appropriate and desirable tool for protecting the real terms capital value of cash over a multi-year investment horizon from the impact of inflation and are thus consistent with the security objective that is at the heart of the Corporation's TMSS.

12. All other participants in the TMSS, which either have a relatively short investment horizon (City's Cash and BHE) or relatively small amounts of cash to invest and thus a lower tolerance for volatility, would benefit from an increase in average credit quality at the expense of lower expected returns.

13. This option also avoids a proliferation of individual strategies and investment portfolios that accompanies Option B.

14. Officers therefore recommend that paragraph 5.1 of 2022/23 TMSS is amended in line with Option A. The proposed wording of this amendment is presented (and highlighted) in an extract of the 2022/23 TMSS at Appendix 1.

15. Officers further recommend that the Bridge House Estates Board and the Financial Investment Board agree that funds related to Bridge House Estates and City's Cash and the smaller participants (respectively) are invested in line with the simplified strategy.

Corporate & Strategic Implications

Financial implications

16. Should Members agree to Option A then officers would implement the amendment to the 2022/23 TMSS retrospectively (i.e. backdated to 1 April 2022).

17. Any cumulative changes in the market value of investments as at 31 March 2022 would be treated as realised capital gains/losses in the current year for exiting investors. Collectively, and excluding the City Fund's portion, this would amount to a realised loss of £1.1m as summarised below:

Participant Name	**Realised Loss on disposal of non-specified investments**
City's Cash	- 845,230
BHE	- 222,767
Smaller Participants (Aggregated)	- 46,204
Total	-1,114,201

18. Importantly it should be noted that capital returns comprise only part of the total return delivered by these investments, which also includes income returns. Taken together the short dated bond funds have delivered annualised total returns of 1.16% since the Corporation first invested in these instruments in 2021/22, which

is in excess of returns available from cash over this period (circa 0.60% p.a.).[1] That is to say, overall realised returns have been positive for participants in the TMSS.

Risk implications

19. City Fund would have a marginally more concentrated exposure to non-specified investments (currently short dated bond funds but potentially other investment categories in future) which would mildly increase expected risk and expected returns for the local authority. Officers expect this will be beneficial to the City Fund over the long term, as cash balances are expected to remain sufficiently high to tolerate short term volatility in returns.

20. All other participants in the TMSS (including BHE and City's Cash) would be invested in a portfolio with lower expected volatility and lower expected returns over the medium term. Whilst returns would likely be below those achievable by the original 2022/23 TMSS, they would be smoother from one year to the next, which is an important benefit for participants with a relatively a short investment horizon. Risks to capital would not be completely eliminated, it should be noted, as all participants would continue to hold exposure to credit and counterparty risks which would be managed in accordance with the approved creditworthiness policy within the TMSS.

21. It can also be noted that both treasury portfolios would still be subject to continual review to ensure they remain consistent with the circumstances of the underlying participants and managed within the parameters of the amended TMSS, which itself would be subject regular review and at least on an annual basis.

Other implications

22. The proposal does not entail any significant resource, legal, equalities, climate or security implications.

Conclusion

23. This report proposes an amendment to the Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 (TMSS) to improve the alignment between the strategy and the various individual participants whose treasury management activities the TMSS applies to.

Appendices

- Appendix 1 - Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 (Extract)

Background Papers

Treasury Management Strategy Statement and Annual Investment Strategy 2022/23

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[1] Returns for the non-specified investments are calculated using the internal rate of return method over the Corporation's investment holding period to 31 March 2022. Benchmark rates are calculated using a combination of daily one year LIBID rates and daily one year SONIA rates over the equivalent period.

APPENDIX 1

Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 (Extract)

5. Annual Investment Strategy

The Annual Investment Strategy sets out how the City will manage its surplus cash balances for the forthcoming year (i.e. investments held for treasury management purposes). It does not apply to other long-term investment assets, which are dealt with variously by other strategy documents (for instance the Capital Strategy for City Fund, or the Investment Strategy Statement for Bridge House Estates).

5.1. Investment Policy

The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This strategy deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

The City of London's investment policy will have regard to the DLUHC'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 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 DLUHC 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 3 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 Fund will have exposure to Specified and Non-specified Invstments. All other participants in the Treasury Management Strategy Statement and Annual Investment Strategy 2022/23 will have exposure to Specified Investments only.

The City will also set a limit for the amount of its investments which are invested for longer than 365 days (see Appendix 2).