Committee: Investment Committee	**Dated:** 07 July 2023
Subject: Treasury Management Update as at 31 May 2023	**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 Discussion / Information**
Report author: Adam Buckley – Chamberlain's Department	

Summary

This report provides a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 May 2023. 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.

The treasury position was last reviewed by the Financial Investment Board at their final meeting on 17 February 2023, when they received a report outlining the treasury position as at 31 December 2022.

Whilst the annual consumer price inflation (CPI) fell to 8.7% in the year to April 2023, from 10.5% as at December 2022, this 8.7% level was maintained in the year to May 2023, which exceeded both the market and Bank of England's expectations of 8.2% and 8.4% respectively, and hence the outlook on interest rates has evolved. The Bank of England's Monetary Policy Committee (MPC) has continued to raise the base rate incrementally from 3.50%, which was applicable at 31 December 2022, to 5.00% in June 2023, the thirteenth successive rise since December 2021 and markets are currently moving to a new assumed 'terminal' base rate of near 6.00% by the end of the year.

This increase in rates has allowed the Corporation to obtain higher yields through its allocation to fixed term deposits, and officers expect interest income to increase further over the course of 2023/24 if the expected continued tightening in monetary policy materialises.

Recommendation

Members are asked to note the report.

Main Report

Background

1. The Investment Committee (which was established 19 May 2023 following the dissolution of the Financial Investment Board) will receive 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 May 2023.

Current Position

2. The treasury management investment portfolio had a market value of £1,112.1m as at 31 May 2023, which is a decrease of £140.4m from the balance reported previously as at 31 December 2022 (£1,252.5m). This decrease relates to the seasonal profile of the organisation's annual cash cycle, whereby the final quarter of the year usually experiences a net outflow of cash, and included:-

   - a scheduled payment to return business rates relief funds (£67.5m);
   - an additional payment relating to 2021/22 National Non-Domestic Rates (NNDR-3) outturn adjustments (£31.5m);
   - City's Cash capital expenditure on the purchase of the long lease of Europa Trade Park (£26.5m);
   - expenditure on Major projects of circa £39.3m;and
   - the normal cycle of reductions in the amount of NNDR income in the last quarter of the financial year (1 January – 31 March 2023).

<u>Asset Allocation</u>

3. In accordance with the current Treasury Management Strategy Statement 2023/24, 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 May and 31 March 2023 compared to the position previously reported to the Financial Investment Board is displayed in table 1.

Table 1: Asset allocation as at 31 May 2023

	31-Dec-2022		**31-Mar-2023**		**31-May-2023**	
	£m	**£m**	**%**		**£m**	**%**
Fixed Term Deposit	655.0	52%	535.0	51%	505.0	46%
Notice accounts	160.0	13%	140.0	13%	115.0	10%
Short Dated Bond Funds	148.4	12%	151.0	15%	149.5	13%
Ultra Short Dated Bond Funds	137.9	11%	139.2	13%	140.0	13%
Liquidity Fund	151.2	12%	82.5	8%	202.6	18%
Total	**1,252.5**	**100%**	**1,047.7**	**100%**	**1,112.1**	**100%**

5. As at 31 May 2023, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks via fixed term deposits (46%)

as the Corporation has taken advantage of higher rates available in the sterling money markets (see figure 1 below and paragraph 10). However, the allocation to fixed term deposits has decreased by £150m over the five months since December 2022, in line with the decrease in the cash balance as noted in paragraph 2. Therefore, a greater proportion is now held in the Liquidity funds (18%) to support this expenditure, as these balances are very liquid and can be accessed on the day. The increase in Liquidity funds of £51.4m has primarily been funded by the redemption of £45m from a notice account, which currently represent 10% of the allocation.

6. The ultra-short dated bond funds account for 13% of the treasury portfolio. 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 at least three years (the average duration In light of this volatility, the Treasury Management Strategy Statement (TMSS) was amended with effect from 1 April 2022, so that only City Fund would maintain exposure to the short dated bond funds.

7. Further analysis on the composition of the portfolio as at 31 May 2023 is provided in the Monthly Investment Report at Appendix 2. A summary of counterparty exposure is also included at Appendix 1.

<u>Performance</u>

8. Since December 2023, the Bank of England has continued to increase its Bank Rate, from 3.50% to 4.5% in May 2023, and more recently 5.0% at June 2023 in successive moves at each of the last thirteen meetings of the MPC. The accompanying policy statement from the June meeting maintained the comment that *"...if there were to be evidence of more persistent [inflation] pressures, then further tightening of monetary policy would be required*". In light of the level of inflation, and following the hawkish comments from incoming MPC member Megan Greene on 5 July 2023, who will be replacing ultra-dove Silvana Tenreyro, the markets are giving direction for future movements towards the new assumed 'terminal' base rate of near 6.00% by the end of the year. As the 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. The capital value of the Corporation's bond fund investments have marginally declined in the reporting period (i.e. when interest rates increase, bond prices decrease and vice versa), however, yields have increased which has improved their total returns as at the reporting date. That is, income, rather than capital gains, have made up a greater part of the total return generated by these funds during this period. 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 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.

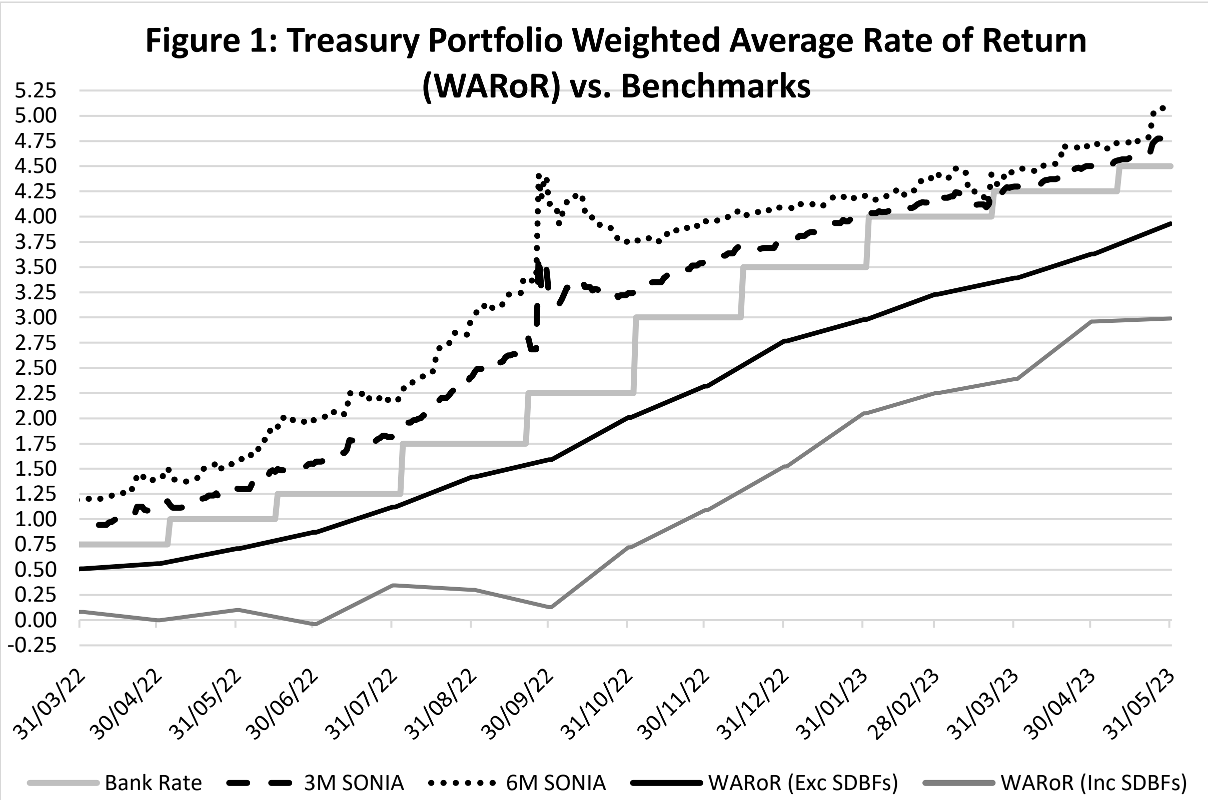

Figure 1: Treasury Portfolio Weighted Average Rate of Return (WARoR) vs. Benchmarks

10. Sterling money market rates have risen steadily in line with bank rates increases throughout most of 2022 and the start of 2023, although they rose sharply at the end of September 2022 due to the Governments proposed fiscal stimulus plans, as investors demanded a higher risk premium and expected faster and higher interest rate rises to offset the perceived risk of the proposed significant tax cuts to the UK economy, as shown in figure 1 via the readings for 3-month and 6-month Sterling Overnight Index Average Rate (SONIA). Rates subsequently eased as the government reversed its plans and the Bank of England moved to quell market unease, though rates are still trending upwards in line with expected bank rate increases as the MPC moves to try and ease inflation.

11. Returns on the Corporation's short term investment portfolio excluding short dated funds have trended upwards in 2023, as lower yielding deposits have matured and been replaced with new investments at a higher yield, as the Corporation capitalised on the increase in interest rates. 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). If monetary policy is continually tightened over the course of 2023/24 then officers expect this rate of return to increase from current levels.

12. 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) in order to capitalise on the more favourable market rates.

13. 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 May 2023 in calculating the portfolio returns displayed in figure 1 (i.e. the WARoR (Weighted Average Rate of Return)). Returns on these investments have increased since the end of 2022, however, over the last year as a whole, returns on the short-dated bonds (L&G and Royal London) have reduced, which largely reflects the continued rising interest rate environment.

14. 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 May 2023

Fund	**1 Month Return (30/04/2023 to 31/05/2023)**	**5 Month Return (31/12/2022 to 31/05/2023)**	**12 Month Return (31/05/2022 to 31/05/2023)**
Federated Hermes Sterling Cash Plus Fund	0.34%	1.59%	2.71%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.35%	1.73%	3.01%
Payden Sterling Reserve Fund	0.00%	1.46%	1.25%
L&G Short Dated Sterling Corporate Bond Index Fund	-1.10%	0.96%	-3.09%
Royal London Investment Grade Short Dated Credit Fund	-1.84%	0.41%	-3.03%

15. 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.

16. The increase in interest rates has had a negative effect on these short dated bond funds total returns over the last 12 months, although this has occurred after a sustained period of price appreciation prior to 2021/22.

17. 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. 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.

18. Notwithstanding the decline in capital values, as interest rates rise the bond managers will be able to reinvest the maturing bonds at a higher yield, thus raising the level of income in the portfolio, that is, income, rather than capital gains, should make up a greater part of the total return generated by these funds. The income

(distribution) yield on the bond funds with Royal London and L&G are 3.80% and 3.20% respectively as at the end of April 2023.

19. 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 has been extended for a further 2 years until 31 March 2025, 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.

20. However, officers are reviewing the historic and anticipated future performance of these funds, with consideration as to whether dis-investment, and any possible realised capital loss, would be offset by more favourable returns from an alternative investment class.

21. Currently, interest generated from short-dated bond funds are automatically reinvested, either by accumulating more shares or by increasing the price of the shares already held. Officers are reviewing whether interest from these investments can instead be distributed, and therefore can be invested in instruments that are currently producing higher short-term returns, such as liquidity funds and fixed term deposits.

Cash Flow Forecast

22. The City Fund's medium-term cash flow forecast is currently being reviewed along with all the capital projects, including the major projects, to develop a detailed forecast and appropriate funding strategy. Stanhope Capital LLP has been appointed to provide a strategic investment advisory function working alongside the City's in-house Corporate Treasury and Investment Property teams, to provide expert advice on the investment strategy/allocation advice between property and financial investments; and advice on how to secure the best rates of return for the differing requirements for City Find and City's Cash. Once this has been finalised a cashflow forecast will be provided.

Conclusion

23. This report has provided a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 May 2023. Cash is invested across a range of counterparties and instruments in accordance with the Corporation's current Treasury Management Strategy Statement 2023/24.

24. Since the Financial Investment Board last reviewed the treasury position as at 31 December 2022, whilst the annual consumer price inflation (CPI) fell to 8.7% in the year to April 2023, from 10.5% as at December 2022, this level of 8.7% was maintained in the year to May 2023, which exceeded both the market and Bank of England's expectations of 8.2% and 8.4% respectively, and hence the outlook on interest rates has evolved. The Bank of England's Monetary Policy Committee (MPC) has continued to raise the base rate incrementally from 3.50%, which was applicable at 31 December 2022, to 5.0% in June 2023 with a 7-2 majority, the thirteenth successive rise since December 2021.

25. In light of the current rate of inflation, and the hawkish comments from incoming MPC member Megan Greene, the markets are currently moving to a new assumed 'terminal' base rate of near 6.00% by the end of the year. This increase in rates has allowed the Corporation to obtain higher yields through its allocation

to fixed term deposits, and officers expect interest income to increase further over the course of 2023/24 if the expected continued tightening in monetary policy materialises.

26. The capital value of the Corporation's short-dated bond fund investments has marginally decreased in the reporting period as market rates have increased. These investments are appropriate for surplus cash balances that can be invested sustainably over the medium term given the expectation for higher returns over this time horizon, and they continue to generate strong income returns. Albeit, officers are currently reviewing historic and anticipated future performance of these funds, with consideration as to whether disinvestment at some stage, and any possible realised loss, could be offset by more favourable returns from an alternative investment class.

Appendices

Appendix 1: Counterparty Exposure as at 31 May 2023
Appendix 2: Monthly Investment Analysis Review May 2023

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APPENDIX 1: COUNTERPARTY EXPOSURE AS AT 31 MAY 2023

	Counterparty Limit £M	Total Invested as at 31-May-23 £M	Average Rate of Return %
TOTAL INVESTED		**1,112.1**	**2.99%**
FIXED TERM DEPOSITS			
UK BANKS			
Barclays	100.0	85.0	4.74%
Goldman Sachs	100.0	35.0	4.00%
NatWest	100.0	50.0	2.80%
		170.0	
BUILDING SOCIETIES			
Leeds	20.0	20.0	2.09%
		20.0	
FOREIGN BANKS			
DBS Bank	100.0	65.0	4.23%
Helaba	100.0	50.0	2.79%
National Australia Bank	100.0	65.0	4.84%
Rabobank	100.0	35.0	3.62%
Toronto Dominion Bank	100.0	100.0	4.75%
		315.0	
LIQUIDITY FUNDS			
Aberdeen SLI Liquidity Fund	100.0	31.0	4.05%
CCLA - Public Sector Deposit Fund	100.0	50.8	4.12%
Deutsche Global Liquidity Fund	100.0	43.0	4.18%
Federated Prime Liquidity Fund	100.0	40.0	4.04%
Invesco Sterling Liquidity Fund	100.0	37.8	4.08%
		202.6	
ULTRA SHORT DATED BOND FUNDS			
Payden Sterling Reserve Fund	100.0	62.0	1.25%
Aberdeen SLI Short Duration Fund	100.0	52.0	3.01%
Federated Sterling Cash Plus Fund	100.0	26.0	2.71%
		140.0	
SHORT DATED BOND FUNDS			
L&G	100.0	74.9	-3.09%
Royal London	100.0	74.6	-3.03%
		149.5	
NOTICE ACCOUNTS			
Australia and New Zealand 185 Days Account*	100.0	90.0	4.43%
Santander 365 Days Account**	100.0	25.0	3.90%
		115.0	
TOTAL		1,112.1	

**Since the end of May, £45m has been returned (maturity date 05/06/23).*
***Notice has been given on this account, with the full £25m returning on 01/12/2023.*