City of London Corporation - City Fund

Statement of Investment Policy Outline Draft v5 23.6.23

1. Background

The City Fund covers the activities of the City of London Corporation (the City Corporation) as a local authority, police authority and port health authority. It receives grants from central government, a share of business rate income and the proceeds of the local council tax. It also generates rental income through its investment portfolio and interest income separately through its treasury management activities, which have their own set of guidelines. Over time, the City Fund has built up a substantial portfolio of investment properties in the City and adjoining areas.

2. Governance

The responsibility for setting the objectives and policy for the City Fund's investment portfolio lies with the City Corporation's Finance Committee and Policy & Resources Committee which are made up of Members of Court of Aldermen and Court of Common Council advised by the City Corporation's executive team.

The City Fund investment portfolio is wholly invested in property and can only be invested in property. It is managed by the City's internal property management team.

The City Corporation's Investment Committee is responsible for implementing the portfolio's investment policy and reports to the Court of Common Council in relation to its activities and overall performance in respect of the property portfolio.

See appendix for details of the governance structure and terms of reference of the various committees.

3. Time horizon

The time horizon for the investment portfolio is very long term, effectively perpetual.

The long-term time horizon allows for investment in a potentially higher returning but illiquid asset class such as property despite the risk of fluctuations in capital values. The time horizon means the City Corporation can accommodate sizeable short-term fluctuations in capital values as they should not have a detrimental impact on long-term returns.

4. General principles

There are a number of general principles governing the management of the City Fund's investment portfolio.

- Firstly, services and commercial investments must follow CIPFA's Prudential Code. The main requirements are:

  a) *The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e., that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;*

  b) *An authority must not borrow to invest for the primary purpose of commercial return;*

  c) *It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;*

   d) *An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;*

   e) *A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream.*

- Secondly, in order to maintain the core of the portfolio in the interest of future generations, freehold investments within the City itself should not generally be sold.
- Thirdly, the portfolio should be managed actively to increase capital values over time and therefore the potential income generated by the portfolio for the use of current and future generations.
- Finally, reflecting risks posed by climate change, the portfolio should be managed in a way that takes account of the City Corporations' commitment to reducing carbon emissions across its activities.

5. Return objectives

The investment portfolio's primary purpose is to support the City Corporation in its role as local authority through the generation of income.

Capital can also be distributed from the portfolio but only if it is invested in other capital projects: it cannot be used to support day-to-day services or fund the City Corporation's operating costs.

Income target

The investment portfolio should generate a steady and growing level of income through active management of the underlying assets in the portfolio. In normal circumstances, income is expected to grow at least in line with inflation as measured by the long-term Consumer Price Index (CPI).

The current income yield on the investment portfolio is around 3%. This is not a formal yield target for the portfolio but in normal circumstances, the portfolio would be expected to yield at least this amount.

Total return target

To preserve capital and income in real terms after inflation and the distribution of income, the total return target for the investment portfolio including income has been set at CPI inflation +3% p.a. over five year rolling periods.

Relative return objective

As the underlying properties in the investment portfolio are largely in the City and Greater London region, the portfolio is also expected to outperform the MSCI Greater London Property Index over five year rolling periods.

6. Liquidity requirement

In normal circumstances, there is no need to hold a minimum level of cash or cash equivalents in the investment property portfolio as sufficient cash for operating purposes is held in Treasury balances.

The City Corporation's large scale capital spending programme over the next five years will likely require sizeable drawdowns on the portfolio. These will be funded in a timely fashion from asset sales as necessary, with the proceeds from the sales held in cash and short dated bonds ahead of their drawdown.

Treasury Management (including Borrowing)

Each year the City is required to publish a “Treasury Management Strategy Statement and Annual Investment Strategy Statement relating to Treasury Management“ (TMSS), which is approved by the Court of Common Council.

This document covers the Treasury activities for the local authority (City Fund) and includes capital expenditure plans and associated prudential indicators, the minimum revenue provision (MRP), the borrowing strategy and creditworthiness policy. It includes various Treasury and Prudential Indicators required to be set for the City Fund to ensure that the Corporation’s capital investment plans are affordable, prudent, sustainable and help the organisation identify and control the risks around its treasury management activity.

Local authorities are legally required to set aside a prudent amount for the provision of the repayment of prudential borrowing from revenue each year (the MRP) and currently the City Fund is not in a position to borrow.

7. Risk tolerance

The long-term time horizon for the investment portfolio allows for a relatively high degree of volatility in terms of total returns as it provides sufficient time for any short-term declines in capital values to be recovered. Over short-term periods, the stability of income is more important than stability in capital values.

In normal circumstances, given the nature of property investments, it would be expected that volatility in terms of total returns would relatively low (higher than government bonds but substantially below equity market volatility).

It is accepted that the focus of the portfolio on the City and bias towards the office sector brings with it a high degree of specific risk which may mean that the portfolio underperforms the broader commercial property market in the UK significantly at times. Over time, it is expected that this risk will be reduced through diversification.

The City Corporation’s overall risk tolerance is not formally defined in terms of the volatility of returns or maximum permitted downside risk to capital because the level of volatility in markets and therefore the potential downside risk changes over time but it is assumed that the maximum potential fall in the capital value of the investment portfolio in normal market conditions (defined as 98% of possible outcomes) will be in the range 10-15%, albeit in times of crisis (the other 2% of possible outcomes) the downside risk to capital could be substantially larger.

8. Sustainability

The City Corporation as an organisation recognises the threat to society posed by climate change and has developed a comprehensive plan to reduce its carbon emissions across its various activities, including its investment portfolios.

Formal targets for achieving net zero carbon emissions have been set for the City Fund’s investment portfolio taking into account the characteristics of its underlying investments. The internal management team are expected to obtain minimum EPC B ratings for the directly managed properties in the portfolio by 2030 and achieve net zero carbon emissions across the whole of the investment portfolio by 2040.

More generally, the internal management team are also expected to take account of environmental, social and government (ESG) issues when assessing potential tenants and new investments for the portfolio.

The City Corporation also seeks to identify sustainable investment opportunities, where they are aligned with its broader objectives.

See appendix for details of carbon targets and monitoring in the investment portfolio.

9. Responsible investment

The City Corporation is committed to being a Responsible Investor and the long-term steward of the assets in which it invests. Its positive approach to responsible investment is enshrined in its Responsible Investment Policy, which can be found **here**.

Among the key elements of the policy, the City Corporation:

- ensures that its investments reach and exceed the standards set by United Nations supported Principles for Responsible Investment, by incorporating the six principles into investment analysis and decision-making processes;
- is committed to ensuring that modern slavery is not taking place in its business, jurisdiction or supply chains and is committed to using its wider influence to reduce modern slavery risks and impacts; and
- recognises that transparency and disclosure is an important aspect of being a responsible investor.

10. Review process

This Statement of Investment Policy is formally reviewed by the Investment Committee and the Finance Committee on an annual basis.