Committee: Investment Committee	**Dated:** 22 September 2023
Subject: Treasury Management Update as at 31 July 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**
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 July 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 Investment Committee at the meeting on 07 July 2023, when they received a report outlining the treasury position as at 31 May 2023.

The treasury management investment portfolio had a market value of £1,194.8m as at 31 July 2023, which is an increase of £82.7m from the balance reported previously as at 31 May 2023 (£1,112.1m).

The annual consumer price inflation rate in the UK dropped to 6.8% in July 2023, down from 7.9% in June 2023, but exceeded market expectation of 6.7%. The Bank of England's Monetary Policy Committee (MPC) has continued to raise the base rate incrementally from 4.50%, which was applicable at 31 May 2023, to 5.00% in July 2023, to 5.25% in August 2023, the fourteenth successive rise since December 2021. Markets no longer expect a 'terminal' base rate of 6.00% by the end of the year, instead pricing for a peak of 5.75% in December 2023.

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 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 July 2023.

Current Position

2. The treasury management investment portfolio had a market value of £1,194.8m as at 31 July 2023, which is an increase of £82.7m from the balance reported previously as at 31 May 2023 (£1,112.1m). This increase is principally due to:-

   - Home Office grant receipts received in the reporting period (£80.7m);
   - a drawdown by Bridge House Estates (BHE) from Pyrford (£25m); and
   - a City's Cash receipt from the sale of 42 Conduit Street (£7.1m); offset by
   - City's Cash capital expenditure on the purchase of 3–9 Brewery Road N7 (£12.1m); and
   - expenditure on Major projects of circa £12.6m.

<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 July, 31 May and 31 March 2023 is set out in Table 1.

Table 1: Asset allocation as at 31 July 2023

	31-Mar-2023		31-May-2023		31-July-2023	
	£m	%	£m	%	£m	%
Fixed Term Deposit	535.0	51%	505.0	46%	525.0	44%
Notice accounts	140.0	13%	115.0	10%	70.0	6%
Short Dated Bond Funds	151.0	15%	149.5	13%	151.2	12%
Ultra Short Dated Bond Funds	139.2	13%	140.0	13%	141.1	12%
Liquidity Fund	82.5	8%	202.6	18%	307.5	26%
Total	**1,047.7**	**100%**	**1,112.1**	**100%**	**1,194.8**	**100%**

5. As at 31 July 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 (44%). The allocation to fixed term deposits has increased by £20m over the two months since July 2023, as the Corporation has taken advantage of higher rates available in the sterling money markets (see figure 1 below and paragraph 12). The increase has been funded by the redemption of £45m from notice accounts, which now make up around just 6% of the portfolio, as funds have been disinvested from this instrument due to available rates lagging behind the steep rise in fixed term deposit rates. The remaining funds disinvested from notice

accounts were allocated to liquidity funds, along with the increase in the cash balance as noted at paragraph 2, which now make up around 26% of the portfolio. The increase in liquidity funds held, was in part to support a scheduled compensation payment to Markets in August 2023. As the fixed term deposits mature, the intention is to reinvest these.

6. The ultra-short dated bond funds account for 12% 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 (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 (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 July 2023 is provided in the Monthly Investment Report at Appendix 2. A summary of counterparty exposure is also included at Appendix 1.

Performance

8. Since May 2023, the Bank of England has continued to increase its Bank Rate, from 4.50% to 5.00% in July 2023 and more recently 5.25% in August 2023, in successive moves at each of the last fourteen meetings of the MPC. The accompanying policy statement from the August MPC 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 a change from previous views, it also stated that the "*current stance of policy is restrictive"*, adding that it would ensure Bank Rate is *"sufficiently restrictive for sufficiently long to return inflation to the 2% Target".*

9. Markets no longer expect a 'terminal' base rate of 6.00% by the end of the year, instead pricing for a peak of 5.75% in December 2023, and rates are then expected to begin easing in the second half of 2024.

10. 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:

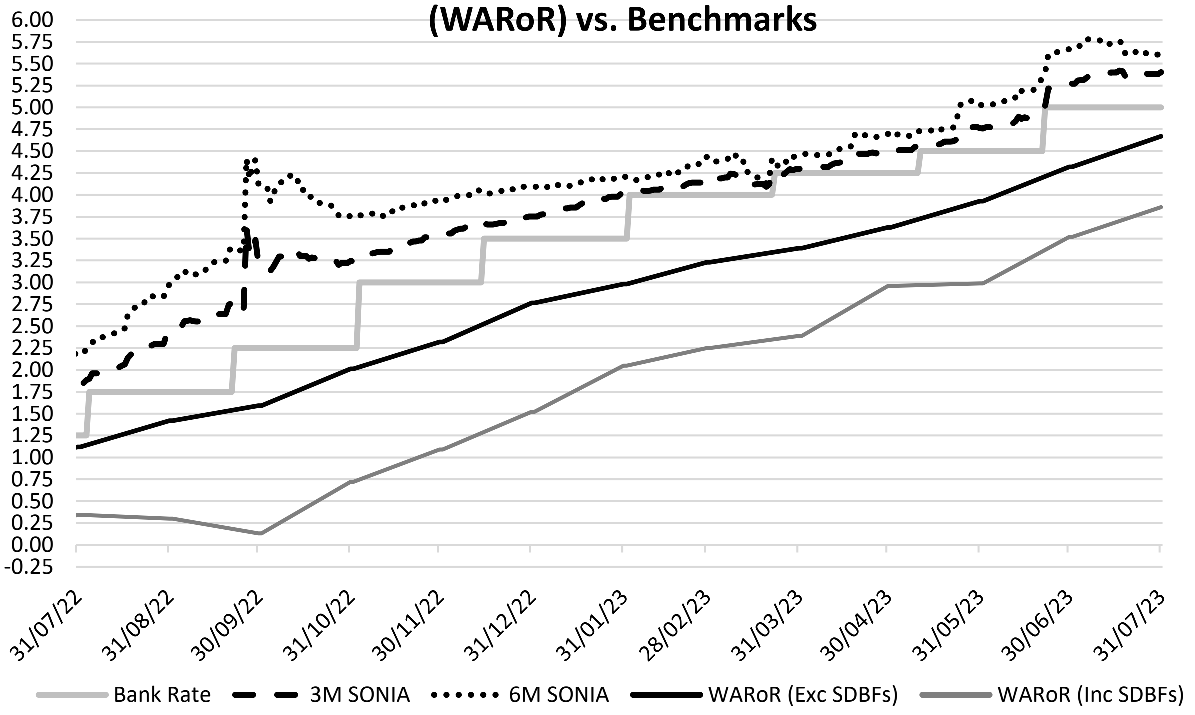
    a. As yields have increased, the capital value of the Corporation's bond fund investments has declined (i.e. when interest rates increase, bond prices decrease and vice versa), however, total returns during the reporting period have slightly increased. That is, income rather than capital gains, have made up a greater part of the total return generated by these funds. 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.

11. These effects can be seen in the weighted average rate of return for the portfolio over the past 12 months and 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



12. Sterling money market rates have risen steadily in line with bank rates increases throughout most of 2022 and the first half 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 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. In August 2023 the Bank of England added *"resilience in the economy"* to its list of persistent inflation pressures, alongside the labour market, wage growth and services CPI inflation.

13. 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.

14. 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.

15. 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 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 in the 4 months since the end of March 2023, however, over the last year to July 2023 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.

16. 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 2023

Fund	**2 Month Return (31/05/2023 to 31/07/2023)**	**4 Month Return (31/03/2022 to 31/07/2023)**	**12 Month Return (31/07/2022 to 31/07/2023)**
Federated Hermes Sterling Cash Plus Fund	0.76%	1.42%	3.34%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.82%	1.52%	3.55%
Payden Sterling Reserve Fund	0.71%	1.02%	1.89%
L&G Short Dated Sterling Corporate Bond Index Fund	0.68%	0.05%	-1.67%
Royal London Investment Grade Short Dated Credit Fund	1.57%	0.22%	-1.77%

17. 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.

18. 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.

19. 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.

20. 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 4.20% and 3.40% respectively as at the end of July 2023.

21. 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.

22. 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.

23. 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 finalising the paperwork to have the interest from these investments distributed, which can then be invested in instruments that are currently producing higher short-term returns, such as liquidity funds and fixed term deposits.

Interest on cash balances

24. A summary of the actual interest on average cash balances (i.e. the returns on the treasury management investment portfolio) as at 31 July 2023, and the forecast for the 2023/24 financial year (1 April 2023 to 31 March 2024) as applicable to City Fund and City's Cash is shown in Table 3 below.

Table 3: Interest on Cash Balances as at 31 July 2023

	2023/24 Original Budget	Actual Interest 1 April – 31 July	2023/24 Forecast outturn	2023/24 Forecast outturn Better / (Worse)
	£'000	£'000	£'000	£'000
Total City Fund & City's Cash Interest on cash Balances	**32,533**	**7,528**	**43,353**	**10,820**

25. Income from interest on average cash balances is currently forecast to exceed budget by £10.8m principally due to higher than anticipated interest rates. The Bank of England base rate has increased from 3% in November 2023, when the budget was set as part of the City of London Corporation's Medium term financial plan (MTFP), to 5% in June 2023, and more recently 5.25% at August 2023.

26. It should be noted that the forecast currently assumes the average split of cash amongst funds to July 2023 will continue for the rest of the year. This assumption is most vulnerable to a rapid drawdown in City's Cash balances and changes in light of the capital expenditure on the major projects.

Cash Flow Forecast

27. 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

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

29. Since the Investment Committee last reviewed the treasury position as at 31 May 2023, the Bank of England's Monetary Policy Committee (MPC) has continued to increase its Bank Rate, from 4.50% to 5.00% in July 2023 and more recently 5.25% in August 2023, the fourteenth successive rise since December 2021. Following August's move, markets are now just shy of fully priced in for a move to 5.50% in September, with a further hike to 5.75% pushed out to December.

30. In August 2023, the Bank of England added *"resilience in the economy"* to its list of persistent inflation pressures, alongside the labour market, wage growth and services CPI inflation, and has maintained the comment that further tightening of monetary policy would be required if there were to be evidence of more persistent inflationary pressures.

31. The 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.

32. Whilst the capital value of the Corporation's short-dated bond fund investments has declined over the last 12 months, 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. However, officers continue to monitor the performance of these funds as 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 July 2023
Appendix 2: Monthly Investment Analysis Review July 2023

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