Committee: Investment Committee Audit and Risk Management	**Dated:** 22 September 2023 6 November 2023
Subject: Treasury Management Outturn as at 31 March 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

The Treasury Management Strategy Statement for 2022/23 was approved by the Financial Investment Board and the Finance Committee in February 2022 and by the Court of Common Council on 10 March 2022. (The Financial Investment Board has now been dissolved and replaced with the Investment Committee with effect from 19 May 2023).

Under CIPFA's Code of Practice on Treasury Management, which was adopted by the Court of Common Council on 3 March 2010, there is a requirement to provide an end of year report. The main points to note are as follows:

- As at 31 March 2023, the City had treasury balances totalling some £1,047.7m. The majority of these balances are held for payment to third parties or are restricted reserves.
- Cash balances decreased by £178.3m over the course of the year, which was principally due to additional unexpected Business Rates payments in 2022/23 in relation to adjustments to the prior year of £157.7m.
- Short term investment returns increased throughout 2022/23, with the Bank of England increasing the base rate in successive moves, starting at 0.75% in March 2022 rising to 4.25% by March 2023. As at August 2023 the base rate stands at 5.25%.
- The investment of funds during the year conformed to the approved strategy and there were no liquidity difficulties or breaches of the approved creditworthiness policy.
- The treasury management strategy was amended during the year in relation to *non-specified investments*[1], i.e. the short-dated bonds funds. 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

[1] ***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*
Specified investments *are those with a high level of credit quality and subject to a maturity limit of one year.*

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.

- In November 2020, HM Treasury revised its requirements for new borrowers using the Public Works Loan Board (PWLB facility), effectively removing the ability of local authorities to borrow for commercial yield. At the same time PWLB reduced the margin added to gilt yields used to price new loans by 100 basis points.
- Post the financial year end, the PWLB guidance was updated on 15 June 2023, in particular publishing a new Housing Revenue Account (HRA) rate, at 40 basis points above prevailing gilts, available from 15 June 2023 for 1 year, with its continuation subject to review. This rate is solely intended for use by HRA and primarily for new housing delivery. Furthermore, the guidance, in line with the Prudential Code, reinforced that local authorities will *"…only borrow the amount needed to finance capital expenditure and not borrow extra amounts purely to invest and make a financial return"* (previously noted purely for yield).

Recommendation

Members are asked to note the report

Main Report

Introduction

1. The City of London Corporation (the City) is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2. The Treasury Management Strategy Statement (TMSS) for 2022/23 was approved by the Financial Investment Board (9 February 2022), Finance Committee (15 February 2022) and the Court of Common Council (10 March 2022). During 2022/23 the Financial Investment Board received investment analysis reports at each Board meeting. (The Financial Investment Board has now been dissolved and replaced with the Investment Committee with effect from 19 May 2023.).

Overall Treasury Position as at 31 March 2023

3. The City's treasury position at the start and end of 2022/23 was as follows:

Table 1	**31 March**			
	Principal 2022	**Rate of Return**	**Principal 2023**	**Rate of Return**
	£m	**%**	**£m**	**%**
Fixed rate funding				
- PWLB	0		0	
- Market	0		0	
	0		0	
Variable rate funding				
- PWLB	0		0	
- Market	(450.0)		(450.0)	
	(450.0)		(450.0)	
Total debt	**(450.0)**		**(450.0)**	
Total investments	**1,226.0**	**0.08 ***	**1,047.7**	**2.39 ***
Net Investments	**776.0**		**776.0**	

* This rate of return includes the short dated bond funds. The rate of return excluding the short dated bond funds was 3.39% (2021/22: 0.51%).

Table 1 demonstrates that short term investments decreased by £178.3m from £1,226.0m as at 31 March 2022 to £1,047.7m as at 31 March 2023, which is largely due to additional unexpected Business Rates payments' in relation to adjustments to the prior year of £157.5m; capital expenditure incurred on the purchase of Unit 1 Fairview Industrial Estate and 85 London Wall (£56.5m); and the first tranche of compensation payment for the Markets. The rate of return refers to the weighted average return of the portfolio as at the balance sheet date, rather than income earned in the period (which is discussed further at paragraph 16). The overall rate of return as at 31 March 2023 was much higher than a year earlier, as interest rates increased throughout 2022/23 due to the tightening monetary policy from central banks, though this had a negative effect on the market value of the City's short-dated bond fund investments.

4. The weighted average rate of return was affected by the short-dated bonds, as bond prices have an inverse relationship with interest rates (i.e. when interest rates increase, bond prices decrease and vice versa), and hence there has been a corresponding decline in short-dated bond fund returns (i.e. *non-specified investments*). However, as interest rates rise, the bond fund managers are 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, will make up a greater part of the total return generated by these funds.

5. Following the consultation undertaken by the Department of Levelling Up, Housing and Communities (DLUHC) on IFRS 9, the Government has extended the current mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds to 31st March 2025. Therefore, any capital gains/losses on the short dated bond funds will continue not to be taken through the City's General Fund (i.e. City Fund). The City are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

6. However, as City Fund is by far the largest participant in the TMSS in terms of investment balances, which are expected to endure for the foreseeable future, in order to ensure the TMSS is best aligned with each and every individual participants particular circumstances, during Autumn 2022 the Financial Investment Board, Finance Committee and Bridge House Estates Board all agreed to amend the TMSS with effect from 1 April 2022, and this was ratified by the Court of Common Council in December 2022. This amendment was to 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* i.e. including the short-dated bond funds) permitted in the current TMSS and a second strategy for others which restricts exposure to *specified investments* only (i.e. excluding the short-dated bond funds).

The Strategy for 2022/23

7. During 2022/23 inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK government polices, resulted in UK interest rates having been volatile right across the curve, from Bank Rae through to 50-year gilt yields.

8. Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for. The expectation within the Treasury Management Strategy Statement (TMSS) for 2022/23, based on the forecast from December 2021 when interest rates were at 0.25%, was for a modest increase of only 0.50% in 2022/23. However, following rate rises in February and March 2022, interest rates moved up continuously in stepped increases of either 0.25% or 0.5%, reaching 4.25% by the end of the financial year in March 2023, with further increases anticipated in 2023/24. As at August 2023 the Bank of England base rate is 5.25%.

9. This sea-change in investment rates resulted in the challenge of pro-active investment of surplus cash for the first time in over a decade, with the need to

seek the appropriate balance between maintaining cash for liquidity purposes, and “laddering” deposits on a rolling basis to lock in investment rates as duration was extended.

10. Starting the 2022/23 financial year at 5.5%, annual CPI inflation rose to 10.1% in July 2022, and then 11.1% in October 2022. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again to 10.4% in February 2023, up from 10.1% in January 2023. As at July 2023 inflation stood at 6.9%.

11. The Corporation’s creditworthiness policy was designed to prioritise the security of the Corporation’s assets whilst also enabling diversification of risk amongst a range of high quality counterparties. Given the increase in economic uncertainty, the creditworthiness criteria set out in the original strategy was maintained throughout the year.

12. The Corporation maintained sufficient liquidity through the selective use of highly liquid money market funds, cash flow forecasting, and active management of the portfolio’s maturity profile.

13. The treasury management function complied with the parameters established in the Treasury Management Strategy Statement 2022/23 for the entirety of the reporting period and the City’s treasury cash continues to be invested in a diversified balanced portfolio commensurate with proper and prioritised levels of security and liquidity.

14. The 2022/23 TMSS also included a number of prudential and treasury indicators for the year which are shown in Appendix 1. The City complied with all indicators in 2022/23.

The Borrowing Requirement and Debt

15. The Corporation did not anticipate (but did not rule out) undertaking any new external borrowing during 2022/23 and instead intended to temporarily use cash balances to support capital expenditure as an interim measure. This policy of internal borrowing was prudent as investment returns were initially low (and thus there would be a cost of carry associated with any new external debt that was not immediately used to fund capital expenditure) and minimising counterparty risk on placing investments also needed to be considered.

16. The majority of local authority borrowing is undertaken via the Public Works Loan Board (PWLB), a government agency. PWLB loans are priced on the basis of prevailing gilt yields plus a margin. As previously reported, the Government increased the margin from its long term position of 80 basis points to 180 basis points in 2019/20 and simultaneously announced a review of the future lending arrangements of the PWLB. These measures were prompted by concerns within Government over the use of PWLB loans to fund commercial investments for yield. On 25 November 2020, the Chancellor announced the conclusion to the review and reversed the earlier 100 basis point increase to the margins whilst simultaneously introducing a prohibition to deny access to borrowing from the PWLB for any local authority which planned to purchase assets for yield in its three-year capital programme.

17. Post the financial year end, the PWLB guidance was updated on 15 June 2023, in particular publishing a new Housing Revenue Account (HRA) rate, at 40 basis points above prevailing gilts, available from 15 June 2023 for 1 year, with its

continuation subject to review. This rate is solely intended for use by HRA and primarily for new housing delivery. Furthermore, the guidance, in line with the Prudential Code, reinforced that local authorities will *"…only borrow the amount needed to finance capital expenditure and not borrow extra amounts purely to invest and make a financial return"* (previously noted purely for yield).

18. No external borrowing was undertaken by the City Fund during the 2022/23 financial year, and actual capital expenditure in that year (£102m) was lower than anticipated in the 2022/23 TMSS (£217m). The City Fund's capital financing requirement is expected to increase in the next few years as a result of the planned capital expenditure and it is likely that at least a portion of this borrowing need will be met through internal borrowing. This strategy remains prudent in the current interest rate environment given the City Fund's cash balances. However, the Chamberlain will continue to monitor the outlook for interest rates to ensure the borrowing strategy remains appropriate.

19. City's Cash did not issue any new debt during the year having obtained market debt of £450m in 2019/20. The second and final tranche of that debt of £200m was received in July 2021.

20. Bridge Houses Estates did not enter into any borrowing during the year.

Investment Outturn for 2022/23

21. **Investment Policy** – the City's investment policy is governed by MHCLG guidance on Local Government Investments and the CIPFA Treasury Management Code which has been implemented in the annual investment strategy approved by the Court of Common Council on 10 March 2022. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.)

22. Following the amendment to bifurcate the Annual Investment Strategy within the TMSS into two strategies (see paragraph 6): one for City Fund which includes exposure to the full range of investments (both *specified* and *non-specified* i.e. including the short-dated bond funds) and a second strategy for others which restricts exposure to *specified investments* only (i.e. excluding the short-dated bond funds), this resulted in a two income yields for 2022/23, one for City Fund and one for all other funds.

23. The income yield on short term investments for 2022/23 was 2.13% for City Fund and 1.83% for all other funds. (2021/22: 0.5% across all funds). The increase in income reflects higher returns available from the money markets in 2022/23, largely as a result of ultra-tight monetary policy in place for the latter part of the reporting period.

24. Aside from interest earned on deposits, the portfolio is also exposed to gains and losses on the market value of the Corporation's short dated and ultra-short dated bond funds, which are held at fair value. Each of these investments, and in particular the short dated bond funds which have the highest interest rate sensitivity, depreciated in value over the course of the year (bond prices have an inverse relationship with interest rates).

25. As yields have risen, the capital value of the portfolio's short dated bond fund investments declined resulting in a negative return of 0.79% for the year

(2021/22: -0.71%). As in 2021/22, these movements are debited as an unrealised loss on investments, which is accordance with the IFRS9 current mandatory statutory override (paragraph 5), are reversed and not taken through City Fund. Although capital movements are volatile in the short term, the allocation to short dated bond funds is expected to deliver superior returns over the medium term when compared to traditional deposits

26. The investment activity during the year conformed to the approved strategy, and the City of London had no liquidity difficulties.

Conclusion

27. Treasury management activities over the past financial year were carried out in accordance with the 2022/23 TMSS, which was amended in Autumn 2022 to 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* i.e. including the short-dated bond funds) permitted in the current TMSS and a second strategy for others which restricts exposure to *specified investments* only (i.e. excluding the short-dated bond funds).

28. Money market investment returns, which are heavily determined by central bank activity, have increased as the base rate has increased throughout 2022/23. Rates are currently forecast to increase further over the rest of 2023 with a peak of 5.75% now expected by December 2023, where it is assumed rates will remain before decreasing in the second half of 2024.

Appendices
Appendix 1 – Treasury Indicators

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