Committee: Investment Committee	**Dated:** 12 February 2024
Subject: Treasury Management Update as at 31 December 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 December 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 Treasury Services, is included at Appendix 2.

The treasury position was last reviewed by the Investment Committee at the meeting on 14 December 2023, when they received a report outlining the treasury position as at 31 October 2023.

The treasury management investment portfolio had a market value of £1,005.1m as at 31 December 2023, which is a decrease of £35.4m from the balance previously reported as at as at 31 October 2023 (£1,040.5m).

The annual consumer price inflation rate in the UK rose by 4.0% in the 12 months to December 2023, down from 4.6% in October 2023. The Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate at 5.25% for a third consecutive time at its meeting on 14 December 2023, after the rate was also unchanged at the previous two meetings in November and September 2023. The markets view is that the rate has now peaked at 5.25%, with no cuts expected to materialise until Q2 of 2024, with subsequent cuts expected in the latter stages of the year.

This increase in rates has allowed the Corporation to obtain higher yields across its asset allocations, and officers expect interest income to be maintained over the remainder of 2023/24 if the MPC's current restrictive policy stance continues.

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 December 2023.

Current Position

2. The treasury management investment portfolio had a market value of £1,005.1m as at 31 December 2023, which is a decrease of £35.4m from the balance previously reported as at as at 31 October 2023 (£1,040.5m). This decrease is principally due to:-

   - business rate refunds (£24.6m);
   - Museum of London drawdowns (£12.2m); and
   - expenditure on Major projects (£9.9m)

<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 December, 31 October and 31 March 2023 is set out in Table 1.

Table 1: Asset allocation as at 31 December 2023

	31-Mar-2023		31-Oct-2023		31-Dec-2023	
	£m	%	£m	%	£m	%
Fixed Term Deposit	535.0	51%	510.0	49%	490.0	49%
Notice accounts	140.0	13%	70.0	7%	90.0	9%
Short Dated Bond Funds	151.0	15%	154.1	15%	159.8	16%
Ultra Short Dated Bond Funds	139.2	13%	143.2	13%	145.1	14%
Liquidity Fund	82.5	8%	163.2	16%	120.2	12%
Total	**1,047.7**	**100%**	**1,040.5**	**100%**	**1,005.1**	**100%**

5. As at 31 December 2023, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks, with the highest allocation via fixed term deposits (49%). Liquidity funds make up around 12% of the portfolio, a reduction of £43m in-line with the decrease in the portfolio total as detailed at paragraph 2 above. These balances are very liquid and can be accessed on the day. Notice accounts now make up 9% of the portfolio, as an additional £20m (net) was re-invested invested during the reporting period.

6. The ultra-short dated bond funds account for 14% 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 (16%) 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 December 2023 is provided in the Monthly Investment Report at Appendix 2. A summary of counterparty exposure is also included at Appendix 1.

Performance

8. The Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate at 5.25% for a third consecutive time at its meeting on14 December 2023, after the rate was also unchanged at the previous two meetings in November and September 2023. As in November, the MPC decision was passed with a vote of 6-3, with the three dissenting votes still favouring further tightening. The accompanying policy statement from the December MPC meeting maintained that rates will stay *"sufficiently restrictive for sufficiently long"* and that *"...if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required".*

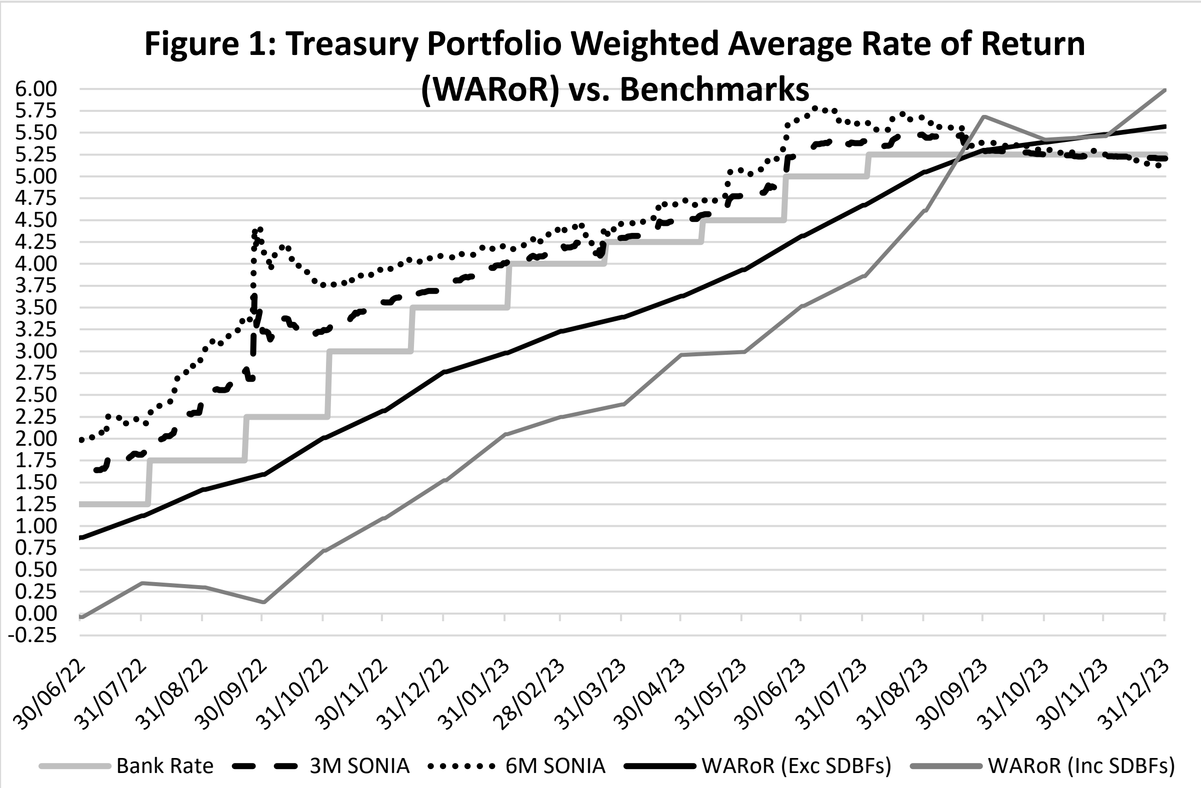
9. As previously reported, the market expectation is that rates have peaked at 5.25%. However, weaker than anticipated employment and growth figures have led markets to start pricing in a cut in the Bank Rate in Q2 of 2024, compared to previous expectations of no cuts until the second half of the year. A further cut to 4.75% is priced in for Q3, and thereafter markets still expect an additional move to 4.25% in December 2024. LINK, our investment consultants, are currently forecasting no further changes in the rate until a decrease in rates in Q3 of 2024, to 4.75%, reaching 4.25% by the end of the year, followed by further rate cuts through 2025 reaching 3.0% by September 2025 where it is assumed to plateau.

10. As the Bank Rate is the primary determinant of short-term interest rates in the UK, these changes impact the treasury investment portfolio, broadly in two ways:

    a. As yields increase, the capital value of the Corporation's bond fund investments decline (i.e. when interest rates increase, bond prices decrease and vice versa), however as rates have now plateaued the capital value is beginning to appreciate, and total returns during the reporting period have increased. 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 has meant that the Corporation has benefitted from materially enhanced returns on new deposits and via the shorter term liquidity funds. A decrease in interest rates will result in reduced future returns from short term money market instruments.

11. These effects can be seen in the weighted average rate of return (WARoR) for the portfolio over the past 18 months and is shown in figure 1 below. In this chart, the two WARoR lines represent the level of returns achieved by the Corporation while the “dashed”, and solid Bank Rate, lines represent suitable performance comparators.



12. Sterling money market rates rose steadily in line with bank rate 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 still trended upwards in line with expected bank rate increases in the first half of 2023 as the MPC moved to try and ease inflation. In the second half of 2023 Sterling money market rates began to ease, as the bank rate reached an assumed peak of 5.25% at the start of August 2023. Sterling money market rates have now begun to decrease, as the market is pricing in a number of Bank Rate cuts over the next 12 months.

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 the current restrictive

monetary policy stance continues over the remainder of 2023/24, then officers expect the current rate of return to be maintained.

14. 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 December 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 2 months since the end of October 2023. The improvement in these returns is reflective of the fact that throughout most of 2023 bond prices weakened amid concerns that major central banks would keep increasing interest rates in order to quell inflation. However, this sentiment changed in November 2023, with growing optimism that inflation was cooling and interest rates would be lowered, and hence investors piled into bonds which drove up prices and triggered a powerfully rally.

15. 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 December 2023

Fund	1 Month Return (30/11/2023 to 31/12/2023)	2 Month Return (31/10/2023 to 31/12/2023)	12 Month Return (31/12/2022 to 31/12/2023)
Federated Hermes Sterling Cash Plus Fund	0.47%	0.94%	4.82%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.51%	0.98%	5.02%
Payden Sterling Reserve Fund	1.04%	1.75%	5.64%
L&G Short Dated Sterling Corporate Bond Index Fund	2.46%	4.13%	8.00%
Royal London Investment Grade Short Dated Credit Fund	2.51%	3.20%	8.37%

16. 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. The steadying in interest rates rises, especially since the end of July 2023, compared to the sharp rise in September 2022, has had a positive effect on these short dated bond funds total returns over the last 12 months.

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. 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.

19. As interest rates rise the bond 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, has generally made 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 4.37% and 3.70% respectively as at the end of December 2023.

20. Previously, Interest generated from short-dated bond funds was automatically reinvested, either by accumulating more shares or by increasing the price of the shares already held. The interest from these investments is now distributed, quarterly for RLAM (the first distribution of £866k was received in December 2023 for the 3-month period August-October) and twice yearly for L&G (the first distribution will be in April 2024 for the 6-month period August 2023-February 2024).

<u>Interest on cash balances</u>

21. A summary of the interest on *average cash balances* (i.e. the returns on the treasury management investment portfolio) as at 31 December 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 December 2023

	2023/24 Original Budget	**2023/24 Forecast outturn**	**2023/24 Forecast outturn Better / (Worse)**
	£'000	**£'000**	**£'000**
City Fund	**27,026**	**48,296**	**21,270**
City's Cash	**5,507**	**1,179**	**(4,328)**
Total City Fund & City's Cash Interest on average cash Balances	**32,533**	**49,475**	**16,942**

22. Income from interest on *average cash balances* is currently forecast to exceed budget by £16.9m principally due to higher than anticipated interest rates. The Bank of England base rate has increased from 3% in November 2022, when the budget was set as part of the City of London Corporation's Medium term financial plan (MTFP), to 5.25% in August 2023 where it has remained.

23. It should be noted that the forecast currently assumes the average split of cash held amongst funds to December 2023 will continue for the rest of the year.

<u>Cash Flow Forecast</u>

24. 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

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

26. Since the Investment Committee last reviewed the treasury position as at 31 October, the Bank of England's Monetary Policy Committee (MPC) maintained its Bank Rate at 5.25% at its subsequent two meetings in November and December 2023. The markets view is that the rate has now peaked at 5.25%, with a cut to 4.25% expected by the end of 2024.

27. In December 2023, the MPC maintained the commitment to policy maintenance, saying that rates will stay *"sufficiently restrictive for sufficiently long"* and that *"...if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required".*

28. The increase in sterling money market rates in 2023 has allowed the Corporation to obtain higher yields, and officers expect interest income to be maintained over the remainder of 2023/24 if the current restrictive monetary policy stance continues.

29. The capital value of the Corporation's short-dated bond fund investments are beginning to appreciate as the Bank of England base rate has plateaued. 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. The interest from these investments is distributed, quarterly for RLAM and twice yearly for L&G.

Appendices

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

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