Committee: Investment Committee	**Dated:** 3 October 2024
Subject: Treasury Management Update as at 31 August 2024	**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 August 2024. 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 25 July 2024, when they received a report outlining the treasury position as at 31 May 2024.

The treasury management investment portfolio had a market value of £1,134.5m as at 31 August 2024, which is an increase of £77.0m from the balance previously reported as at as at 31 May 2024 (£1,057.5m).

The Consumer Prices Index (CPI) rose by 2.2% in the 12 months to August 2024, unchanged from July 2024, and up from 2.0% in the 12 months to both June and May 2024. The Bank of England's Monetary Policy Committee (MPC) voted to cut interest rates for the first time since March 2020, from 5.25% to 5.00%, at its meeting in August 2024. The market expectation is for further cuts in Q4 of 2024 and Q1 of 2025. However, this sentiment remains volatile and may change in the near-term on the back of fresh central bank events, as well as both domestic and international data releases.

The increase in rates throughout 2023/24 were maintained at the start of 2024/25, allowing the Corporation to obtain higher yields across its asset allocations, however interest income has begun to decrease and officers expect this to continue over 2024/25 if the MPC's restrictive policy stance continues to loosen.

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 August 2024.

Current Position

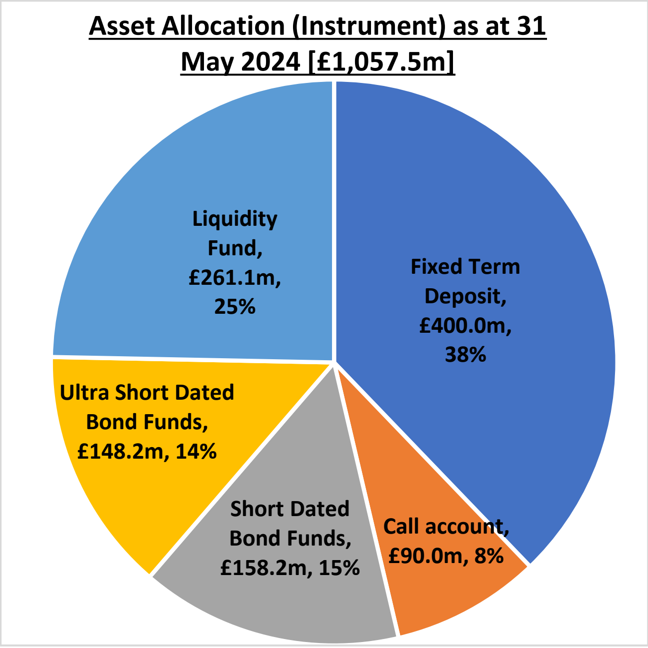
2. The treasury management investment portfolio had a market value of £1,134.5m as at 31 August 2024, which is an increase of £77.0m from the balance previously reported as at as at 31 May 2024 (£1,057.5m). This increase is principally due to:-

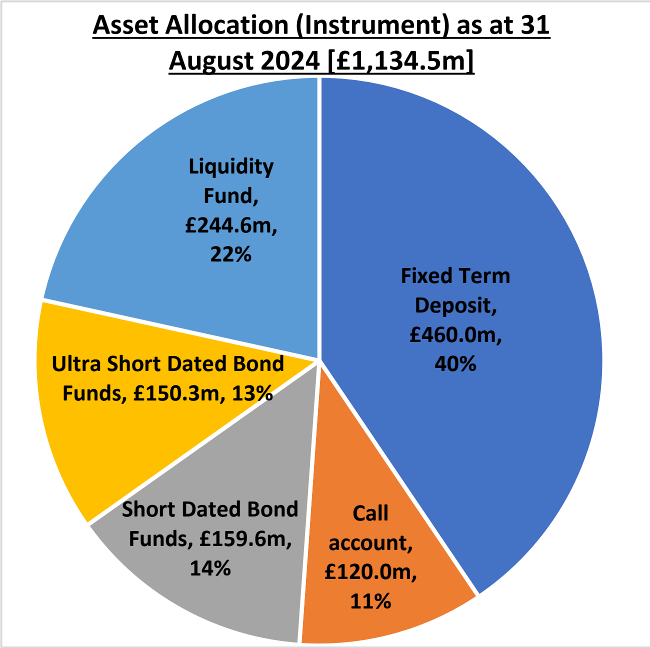
   - Home Office grant income totalling £52.2m;
   - income from GLA regarding the Museum of London relocation project: £30m;
   - financial investment redemptions in the period totalling £33.6m;
   - receipt from the sale of 1-5 Wormwood St & 105-109 Bishopsgate of £6.7m; offset by
   - payments to HMRC in the period (£26.7m);
   - expenditure on Major Projects (£19.3m); and
   - Museum of London drawdown payments (£10.4m).

<u>Asset Allocation</u>

3. In accordance with the current Treasury Management Strategy Statement 2024/25, 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 2024 and 31 August 2024 is set out in Figure 1 below.

Figure 1: Asset allocation as at 31 May 2024 and 31 August 2024



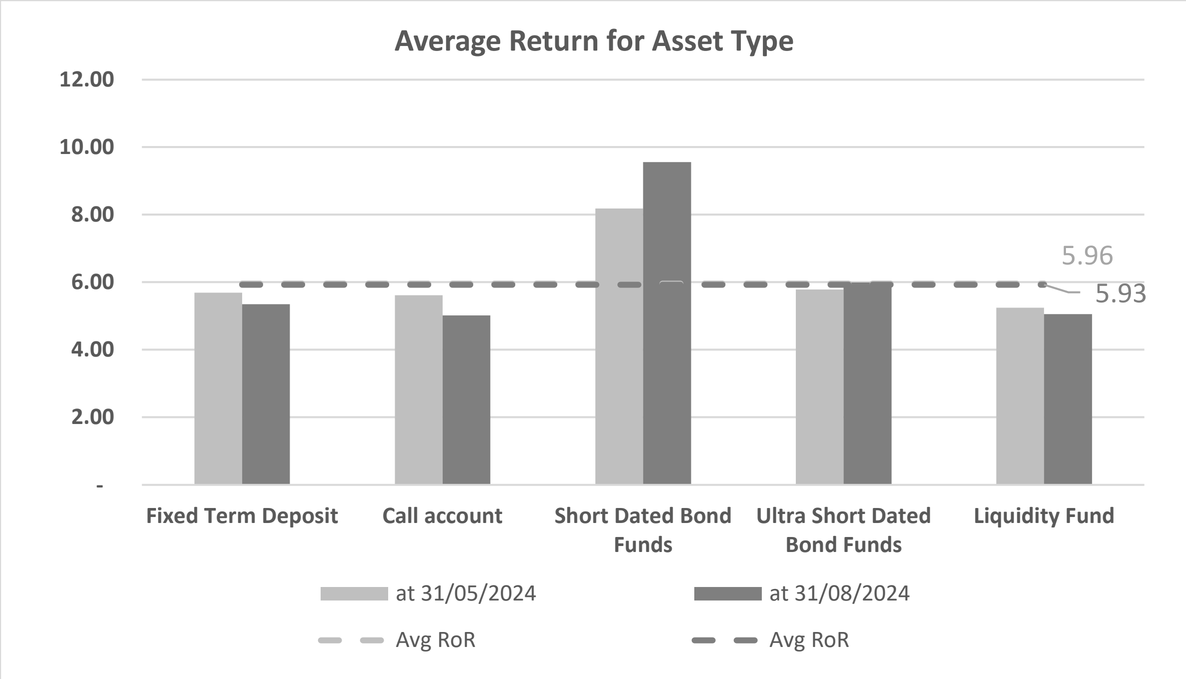


5. As at 31 August 2024, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks, with the highest allocation via fixed term deposits (40%); a rise of £60m from the previous reporting date, due to the increase in the portfolio total as detailed at paragraph 2 above. Liquidity funds now make up around 22% of the portfolio; these balances are very liquid and can be accessed on the day. Notice accounts now make up 11% of the portfolio, as an additional £30m was invested during the reporting period.

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 (14%) 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. A summary of the average return by asset type, as well as the overall average rate of return (RoR), as at 31 May 2024 and 31 August 2024 is shown below in Figure 2. Further analysis on the composition of the portfolio as at 31 August 2024 is provided in the Monthly Investment Report at Appendix 2, which demonstrates the average rate of return for the portfolio as at 31 August 2024 is 5.93% (31 May 2024: 5.96%). A summary of counterparty exposure is also included at Appendix 1, as well an *Economic, Social, & Governance (ESG)* checklist of Treasury Management Counterparties (excluding local authorities) at Appendix 3.

Figure 2: Average Return for Asset Type as at 31 May 2024 and 31 August 2024



<u>Performance</u>

8. The Consumer Prices Index (CPI) rose by 2.2% in the 12 months to August 2024, unchanged from July, and up from 2.0% in the 12 months to both June and May 2024.

9. The Bank of England's Monetary Policy Committee (MPC) voted to cut interest rates for the first time since March 2020 at its August meeting. Five members of the MPC voted to reduce bank rate by 0.25% to 5.00% while four members voted to hold interest rates. The MPC's forward guidance suggests it wants to see more evidence of waning inflationary pressures before embarking on further rate cuts. The accompanying statement gave guidance that policy would *"remain restrictive for sufficiently long until the risks to inflation returning to the 2% target had dissipated further"*, and the MPC have emphasised it *"will decide the appropriate degree of monetary policy restrictiveness at each meeting"*.

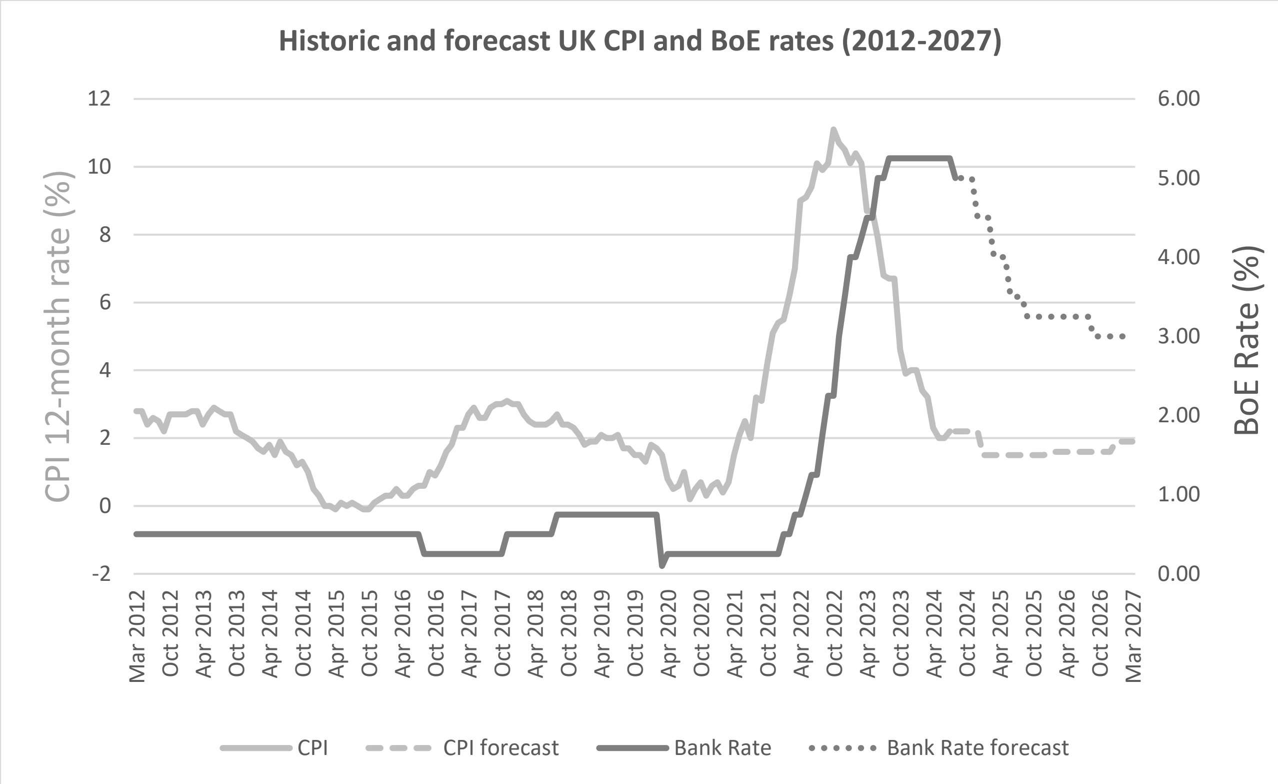
10. Market pricing remains biased towards no change in rates at the next MPC meeting in September, but a cut to 4.75% in November. Further out, sentiment towards a further cut in bank rate in December has eased back, being pushed out to the early stages of 2025. Markets currently forecast bank rate to reach 3.5% by August 2025. However, this sentiment remains volatile and may change in the near-term on the back of fresh central bank events, as well as both domestic and international data releases.

11. LINK, our treasury management consultants, are currently forecasting a decrease in the rates in Q4 of 2024 and Q1 of 2025 reaching 4.0% by March 2025, to be followed by further rate cuts through 2025.

12. A graph showing the historic and forecast UK CPI 12-month rate (based on the Office for Budget Responsibility (OBR) 'Economic and fiscal outlook' March 2024)

and Bank of England base rate (forecast from LINK) from 2012 to 2027 is shown below in Figure 3.

Figure 3: UK CPI 12-month rate / Bank of England base rate



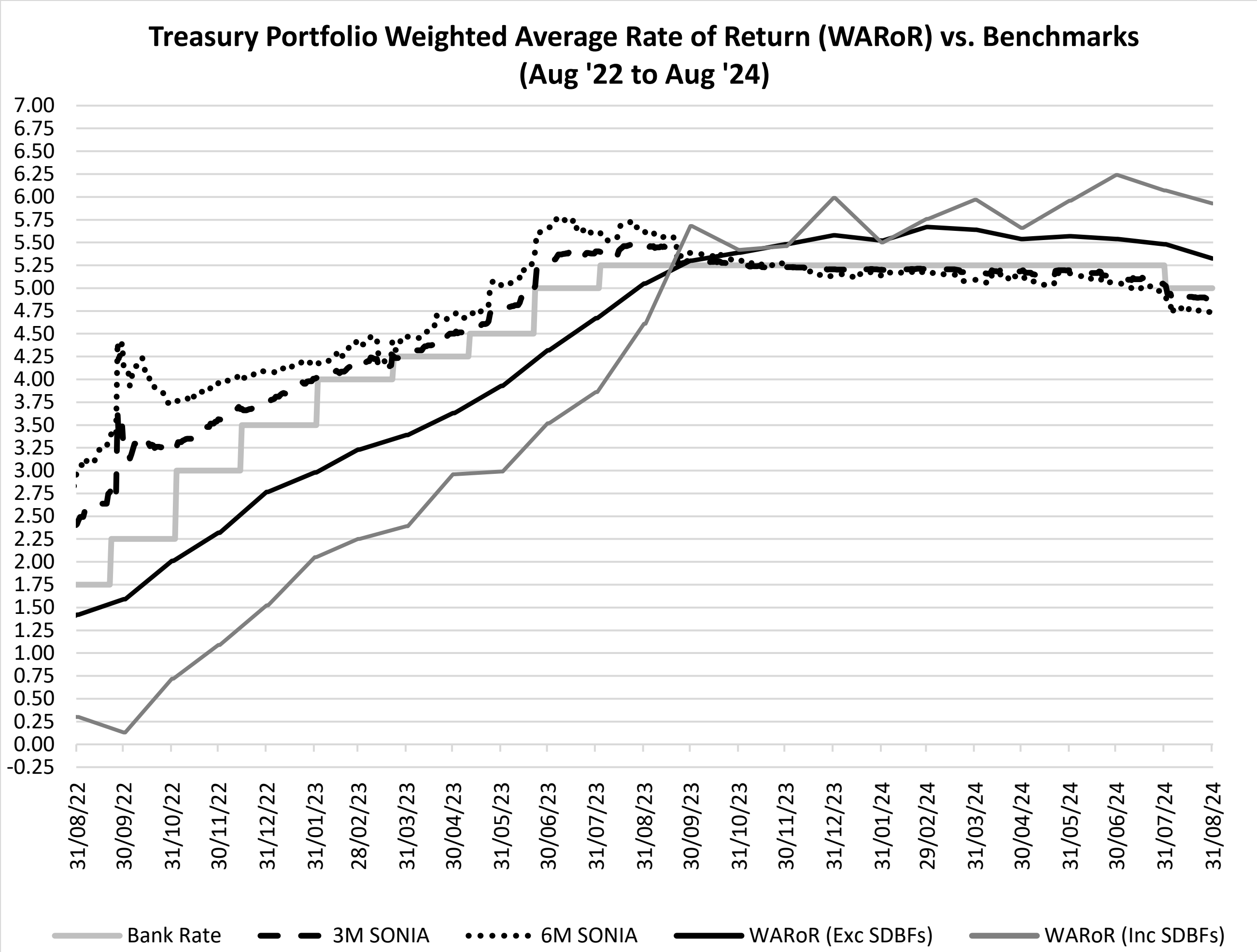
13. As the Bank Rate is the primary determinant of short-term interest rates in the UK, these changes impact the treasury investment portfolio, broadly in two ways:

   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). 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.

14. These effects can be seen in the weighted average rate of return (WARoR) for the portfolio over the past 2 years and is shown in figure 4 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.

Figure 4: Treasury Portfolio Weighted Average Rate of Return vs. Benchmarks



15. 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 3 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 began to decrease in the second half of 2023 as the market priced in a number of Bank Rate cuts over the next 12 months. Money market rates steadied in the first half of 2024 as expectations on future price cuts were pushed back further, and have now begun to decrease as the Bank of England started the loosening cycle, with the MPC's decision to cut interest rates for the first time since March 2020, in August 2024 by 0.25% to 5.00%.

16. Returns on the Corporation's short term investment portfolio excluding short dated funds trended upwards in 2023, as lower yielding deposits matured and 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). Rates were maintained at the end of 2023/24 and the start of 2024/25 as the restrictive monetary policy continued; however the current rate of return on the portfolio has begun to decrease slightly, and officers expect this to continue over the rest of 2024/25, as maturing deposits are likely to be reinvested at rates below those achieved in 2023/24, reflecting the market expectation that the MPC's restrictive policy stance will continue to loosen over the remainder of 2024/25.

17. 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 August 2024 in calculating the portfolio returns displayed in figure 4 (i.e. the WARoR (Weighted Average Rate of Return)). Returns on these investments faced somewhat of a reality check at the start of 2024 following their historic end to 2023. Throughout most of 2023 bond prices weakened amid concerns that major central banks would keep increasing interest rates in order to quell inflation. 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 at the end of 2023. However, in a partial reversal of the positive performance experienced over the final quarter of 2023, bond yields rose in Q1 2024 (meaning prices fell) as the likelihood of interest rate cuts as soon as March were pushed out until later in the year.

18. Whilst inflationary pressures look to be subsiding, non-committal statements from central banks on the future trajectory of interest rates was enough to "spook" investors and hence some of the earlier gains have been given back. The upward trend in yields continued in April 2024, driven by stronger than expected inflation data, albeit this volatility subsided in May 2024, and yields continued to soften in June and July as inflationary pressures eased as markets reacted to evolving monetary policies and major election results. However, volatility surged again at the start of August amidst fears of economic weakness and the biggest one day fall on the Japanese stock market, albeit this was short-lived.

19. To aid an effective assessment of performance, table 1 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 1: Bond Fund Total Returns as at 31 August 2024

Fund	1 Month Return (31/07/2024 to 31/08/2024)	3 Month Return (31/05/2023 to 31/08/2024)	12 Month Return (31/08/2023 to 31/08/2024)
Federated Hermes Sterling Cash Plus Fund	0.44%	1.40%	5.55%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.47%	1.38%	5.76%
Payden Sterling Reserve Fund	0.43%	1.57%	6.41%

L&G Short Dated Sterling Corporate Bond Index Fund	-1.52%	0.52%	9.35%
Royal London Investment Grade Short Dated Credit Fund	-0.73%	1.15%	9.77%

20. The most conservative fund (Federated) is listed first in table 1 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.

21. 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.

22. 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 currently been extended 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.

23. 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 4.80% and 3.90% respectively as at the end of July 2024. The interest from these investments is distributed quarterly for Royal London and half yearly for L&G.

Interest on average cash balances

24. A summary of the interest on *average cash balances* (i.e. the returns on the treasury management investment portfolio) for the 2024/25 financial year (1 April 2024 to 31 March 2025) as applicable to City Fund and City's Estate is shown in Table 2 below.

Table 2: Interest on Cash Balances as at 31 August 2024

	2024/25 Original Budget	**2024/25 Forecast Outturn**	**2024/25 Better / (Worse)**
	£'000	**£'000**	**£'000**
City Fund	**28,900**	**40,485**	**11,585**
City's Estate	**(770)**	**1,296**	**2,066**

Total City Fund & City's Estate Interest on average cash Balances	**28,130**	**41,781**	**13,651**

25. Income from interest on *average cash balances* is currently forecast to exceed budget by £13.6m, principally due to the increase in the level of average cash balances held, and hence available for investment, and upon which interest is applied, compared to that anticipated when the budget was set in November 2023. This is largely as a result of the re-phasing of capital and major project expenditure – as noted at paragraph 27 below the cashflow forecast is currently being reviewed, and will be finalised post the Resource Allocation Sub Committee (RASC) at the end of October 2024.

26. It should be noted that the forecast currently assumes the average split of cash held amongst funds to August 2024 will continue for the rest of the year.

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. Following spending decisions to be taken at Resource Allocation Sub Committee (RASC) at the end of October 2024 the cashflow will be finalised.

Conclusion

28. This report has provided a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 August 2024. Cash is invested across a range of counterparties and instruments in accordance with the Corporation's current Treasury Management Strategy Statement 2024/25.

29. Since the Investment Committee last reviewed the treasury position as at 31 May 2024, the Bank of England's Monetary Policy Committee (MPC) voted to cut interest rates from 5.25% to 5.00% at its August meeting. The markets view is that further cuts will occur over the remainder of 2024/25, with LINK, our investment consultants, currently forecasting a decrease to 4.00% in March 2025.

30. The increase in sterling money market rates in 2023 allowed the Corporation to obtain higher yields, though officers expect the current rate of return on the portfolio to decrease over 2024/25, reflecting the market expectation that the MPC's previous restrictive policy stance continues to loosen over the remainder of 2024/25.

31. The 12 month returns on the Corporation's Short dated bond fund investments remain strong, as yields continued to soften (meaning prices rose) as inflationary pressures ease as markets react to evolving monetary policies and major election results. 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 August 2024
Appendix 2: Monthly Investment Analysis Review August 2024
Appendix 3: Treasury Management Counterparties 2024/25: Economic, Social & Governance (ESG) Checklist

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