Committee: Investment Committee Audit and Risk Management	**Dated:** 3 October 2024 4 November 2024
Subject: Treasury Management Outturn 2023/24	**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/ Information**
Report author: Adam Buckley – Chamberlain's Department	

Summary

The Treasury Management Strategy Statement and Annual Investment Strategy (relating to Treasury Management) for 2023/24 was approved by the Financial Investment Board and the Finance Committee in February 2023 and by the Court of Common Council on 9 March 2023. (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 2024, the City had treasury balances totalling some £901.2m. The majority of these balances are held for payment to third parties or are restricted reserves.
- Cash balances decreased by £146.5m over the course of the year, which was principally due to expenditure related to the Major Projects programme, and an additional Business Rates payment in 2023/24 in relation to adjustments to the prior year.
- Short term investment returns increased throughout 2023/24, with the Bank of England increasing the base rate in successive moves, starting at 4.25% in March 2023 rising to 5.25% by August 2023 where it remained until March 2024. As at September 2024 the base rate stands at 5.00% following a 0.25% reduction on 1 August 2024.
- 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. During the year, a new counterparty was onboarded, United Overseas Bank (UOB). The Treasury Management Strategy Statement and Annual Investment Strategy (relating to Treasury Management) remains appropriate in enabling the City to pursue its prime objectives of security and liquidity, followed by 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 2023/24. 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 and Annual Investment Strategy relating to Treasury Management) *[referred to as the 'The Treasury Management Strategy Statement' or 'TMSS']* for 2023/24 was approved by the Financial Investment Board (17 February 2023), Finance Committee (21 February 2023) and the Court of Common Council (9 March 2023). During 2023/24 the Investment Committee received investment analysis reports at each Committee 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 2024

3. The City's treasury position at the start and end of 2023/24 was as follows:

Table 1	**31 March**			
	Principal 2023	**Rate of Return**	**Principal 2024**	**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	**1,047.7**	**2.39 ***	**901.2**	**5.97 ***
Net Investments	**597.7**		**451.2**	

* This rate of return includes the short-dated bond funds. The rate of return excluding the short-dated bond funds was 5.64% (2022/23: 3.39%). This was reported to Members at the May Committee.

Table 1 demonstrates that short term investments decreased by £146.5m from £1,047.7m as at 31 March 2023 to £901.2m as at 31 March 2024, which is largely due to an additional Business Rates payment in relation to adjustments to the prior year (£57.0m) in March 2024; capital expenditure incurred on the purchase of Europa Trade Park (£26.5m) in April 2023 and 3-9 Brewery Road (£12.1m) in July 2023; and expenditure on Major Projects throughout the financial year. 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 24). The overall rate of return as at 31 March 2024 was much higher than a year earlier, as interest rates increased throughout 2023/24 due to the continued tightening of monetary policy from central banks; albeit less aggressively compared to the prior year, which had a positive effect on the market value of the City's short-date 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 was a corresponding decline in short-dated bond fund returns (i.e. *non-specified investments*) during 2022/23. 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)[1] 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. 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 (now City Bridge Foundation) 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*[2] 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 2023/24

7. During 2023/24, against a backdrop of stubborn inflationary pressures, the Russian invasion of Ukraine, and war in the middle east, UK interest rates continued to be volatile right across the curve, from Bank Rate through to 50-year gilt yields.

8. Investment returns picked up throughout the course of 2023/24 as central banks, including the Bank of England, continued to respond to inflationary pressures that were not transitory, and realised that tighter monetary policy was called for. The expectation within the Treasury Management Strategy Statement for 2023/24, based on the forecast from December 2022 when the Bank of England base rate was at 3.5%, was for an in-year increase up to 4.50%, with an expectation that the base rate would fall back to 4.00% by the end of 2023/24. However, stepped increases of 0.5% in February and 0.25% in March, May, June and August 2023 increased the base rate to an assumed peak of 5.25% where it remained until the end of the financial year in March 2024.

9. By January 2024 it had become clear that inflation was moving down significantly from its 40-year double-digit highs, and the Bank of England signalled in March

[1] *Following the general election on 4 July 2024, DLUHC has reverted to the Ministry of Housing, Communities and Local Government (MHCLG).*

[2] ***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.*

2024 that the next move in Bank Rate would be downwards. As at September 2024 the Bank of England base rate is 5.00%, following an initial cut of 0.25% on 1 August 2024, with the expectation for further cuts to base rate in 2024/25.

10. The upward sloping yield curve that prevailed throughout 2023/24 meant the continued challenge of pro-active investment of surplus cash, 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, became an on-going feature of the investment landscape. In August 2023 the Corporation placed a small amount of the investment portfolio (£30m) in a 3-year fixed term deposit with an approved counterparty, to take advantage of the favourable and assumed peak in interest rates priced into the market, and to lock-in higher investment returns for longer while maintaining sufficient liquidity.

11. In Accordance with the 2023/24 TMSS, the City can place deposits up to a maximum of £25m with individual local authorities and an overall limit of £250m for outstanding lending to local authorities as a whole at any given time. In the latter part of 2023/24, the local authority to local authority market lacked any meaningful measure of depth, forcing short-term investment rates above those available in other markets. The Corporation placed 3 deposits totalling £50m with local authorities in this period. Although the overall credit standing of the local authority sector is considered high, officers performed additional due diligence on individual prospective local authority borrowers prior to entering into any lending.

12. 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. The creditworthiness criteria set out in the original strategy was maintained throughout the year. During the year, a new counterparty was onboarded, United Overseas Bank (UOB), and has been added as an approved counterparty in the Treasury Management Strategy Statement for 2024/25. The inclusion of UOB as an approved counterparty did not change the overall average credit rating of the short-term investment portfolio but allowed the Corporation to further diversify counterparty risk further and reduce reliance on existing counterparties.

13. 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.

14. The treasury management function complied with the parameters established in the 2023/24 TMSS 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.

15. The 2023/24 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 2023/24.

The Borrowing Requirement and Debt

16. The Corporation did not anticipate (but did not rule out) undertaking any new external borrowing during 2023/24 and instead intended to temporarily use cash balances to support capital expenditure as an interim measure. This policy of internal borrowing was prudent as long-term borrowing costs are expected to fall back through 2024 and 2025 as inflation concerns are dampened.

17. 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.

18. 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). Following the Autumn Statement, the availability of this rate has been extended to the end of June 2025.

19. No external borrowing was undertaken by the City Fund during the 2023/24 financial year, and actual capital expenditure in that year (£168m) was lower than anticipated in the 2023/24 TMSS (£444m). 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.

20. City's Cash did not issue any new debt during the year having obtained market debt of £450m in 2019/20. .

21. City Bridge Foundation did not enter into any borrowing during the year.

Investment Outturn for 2023/24

22. **Investment Policy** – the City's investment policy is governed by DLUHC[3] 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 9 March 2023. 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.).

23. 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), has resulted in two income yields for 2023/24, one for City Fund and one for all other funds.

[3] *Following the general election on 4 July 2024, DLUHC has reverted to the Ministry of Housing, Communities and Local Government (MHCLG).*

24. The income yield on short term investments for 2023/24 was 4.82% for City Fund and 4.29% for all other funds. (2022/23: 2.13% for City Fund and 1.83% across all other funds). The increase in income reflects higher returns available from the money markets in 2023/24, largely as a result of the continued tightening of monetary policy in place for the early part of the reporting period.

25. 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, appreciated in value over the course of the year as interest rates plateaued (bond prices have an inverse relationship with interest rates).

26. 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. Despite this, the capital value of the portfolio's short-dated bond fund investments produced a positive return of +0.29% for the year (2022/23: a negative return of -0.79%). As in 2022/23, these movements are debited as an unrealised gain on investments, which is accordance with the IFRS9 current mandatory statutory override (paragraph 5), are reversed and not taken through City Fund.

27. 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. Since the start of the reporting period, officers have instructed for interest from these investments to be distributed with the initial quarterly distribution received in December 2023. In the 7-month period ended 31 March 2024 the interest distributed from these funds totalled £3.2m.

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

Conclusion

29. Treasury management activities over the past financial year were carried out in accordance with the 2023/24 TMSS, which remained unchanged over the course of the year.

30. Money market investment returns, which are heavily determined by central bank activity, have increased as the base rate increased throughout the start of 2023/24 reaching a peak of 5.25% in August 2023. The bank rate is currently 5.00% and rates are forecast to decrease further over the rest of 2024 and 2025, with an expectation of a decrease to 4.50% by the end of 2024 and 3.00% by the end of 2025.

Appendices

Appendix 1 – Treasury Indicators

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Appendix 1

Treasury Indicators

TABLE 1: TREASURY MANAGEMENT INDICATORS	2022/23	2023/24	2023/24
	Actual £M	Estimate £M	Actual £M
Authorised Limit for external debt (City Fund)-			
Borrowing	£0	£0	£0
other long-term liabilities	£12.8	£12.7	£12.7
TOTAL	£12.8	£12.7	£12.7
Operational Boundary for external debt (City Fund) -			
Borrowing	£0	£0	£0
other long-term liabilities	£12.8	£12.7	£12.7
TOTAL	£12.8	£12.7	£12.7
Actual external debt	£0	£0	£0
Upper limit for total principal sums invested for over 364 days (per maturity date)	£300.0	£300.0	£30.0

TABLE 2: Maturity structure of fixed rate borrowing during 2 2023/24	upper limit	lower limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%