City of London Corporation Committee Report

Committee(s): Investment Committee – For Discussion	**Dated:** 2 December 2024
Subject: Treasury Management Update as at 31 October 2024	**Public report:** For Discussion
This proposal: • **delivers Corporate Plan 2024-29 outcomes** • **provides statutory duties** • **provides business enabling functions**	Diverse Engaged Communities; Dynamic Economic Growth; Leading Sustainable Environment; Vibrant Thriving Destination; Providing Excellent Services; and Flourishing Public Spaces
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
Report author:	Adam Buckley, Senior Accountant - Treasury

Summary

This report provides a summary of the City of London Corporation's treasury management portfolio (investments) as at 31 October 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 3 October 2024, when they received a report outlining the treasury position as at 31 August 2024.

The treasury management investment portfolio had a market value of £1,147.6m as at 31 October 2024, which is an increase of £13.1m from the balance previously reported as at as at 31 August 2024 (£1,134.5m).

The Consumer Prices Index (CPI) rose by 1.7% in the 12 months to September 2024, down from 2.2% in the 12 months to both July and August 2024. The Bank of England's Monetary Policy Committee (MPC) voted to maintain interest rates at 5.00% at its meeting in September 2024, though rates were reduced by 25bps to

4.75% at the November MPC. The market expectation is for a further 25bps rate cut in Q1 of 2025, reaching 4.5% by March 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(s)

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 October 2024.

Current Position

1. The treasury management investment portfolio had a market value of £1,147.6m as at 31 October 2024, which is an increase of £13.1m from the balance previously reported as at as at 31 August 2024 (£1,134.5m). This increase is principally due to:-

   - financial investment redemptions in the period totalling £17.0m;
   - receipt from the sale of 55, 57-61, and 85/87 Charterhouse St of £16.4m;
   - receipt from the sale of 59 ½ Southwark St of £13.5m; offset by
   - Museum of London drawdown payments (£23.6m);
   - expenditure on Major Projects (£15.2m); and
   - payments for the purchase of 2-4 Eastcheap (£2.5m).

2. Members should note that during November 2024 the proceeds from the sale of 59 ½ Southwark Street totalling £13.5m were invested in the **BlackRock ICS Sterling Liquidity Fund** (a money market fund (MMF)) to be drawn down as required as the receipt is ring-fenced to support the City's Major Projects programme. This MMF sits outside of the remit of Treasury, and is held as part of City's Estate Financial Investment Portfolio.

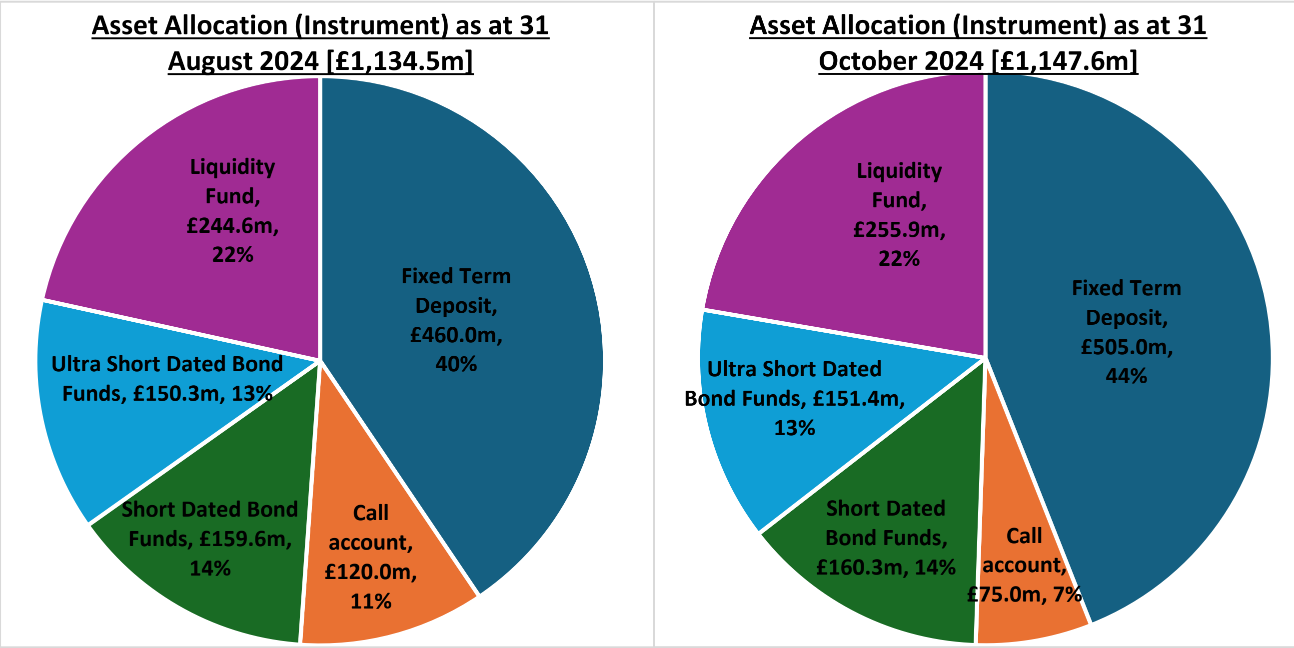
<u>Asset Allocation</u>

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 August 2024 and 31 October 2024 is set out in Figure 1 overleaf.

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

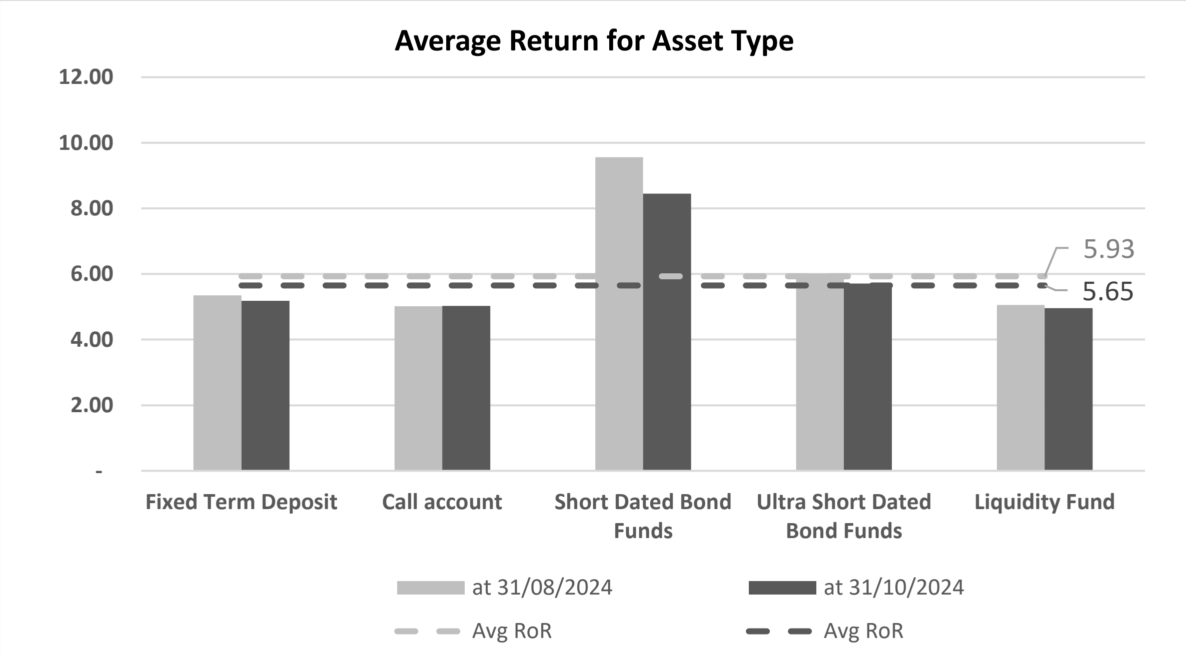


5. As at 31 August 2024, most of the Corporation's cash balances are invested on a short term (under one year) basis with eligible banks, with the highest allocation via fixed term deposits (44%); a rise of £45m from the previous reporting date, as cash from a maturing notice account investment was reinvested as a fixed term deposit. Liquidity funds make up around 22% of the portfolio; these balances are very liquid and can be accessed on the day. Notice accounts now make up 7% of the portfolio, as maturing cash from a variable rate notice account was reinvested into a fixed term deposit for a fixed rate.

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 August 2024 and 31 October 2024 is shown overleaf in Figure 2. Further analysis on the composition of the portfolio as at 31 October 2024 is provided in the Monthly Investment Report at Appendix 2, which demonstrates the average rate of return for the portfolio as at 31 October 2024 is 5.65% (31 August 2024: 5.93%). A summary of counterparty exposure is also included at Appendix 1, as well as 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 August 2024 and 31 October 2024



<u>Performance</u>

8. The Consumer Prices Index (CPI) rose by 1.7% in the 12 months to September 2024, down from 2.2% in the 12 months to both July and August 2024, and well below its peak of 11.1% in October 2022.

9. The Bank Rate was maintained at 5.00% at the September MPC meeting, in line with market expectations. All members of the MPC bar one voted to keep Bank Rate at 5.00%, with the lone dissenter voting for a further 25bps reduction. In the accompanying statement, the Committee doubled down on its commitment to a gradual path of rate reduction, stating that "...in the absence of material developments, a gradual approach to removing policy restraint remains appropriate."

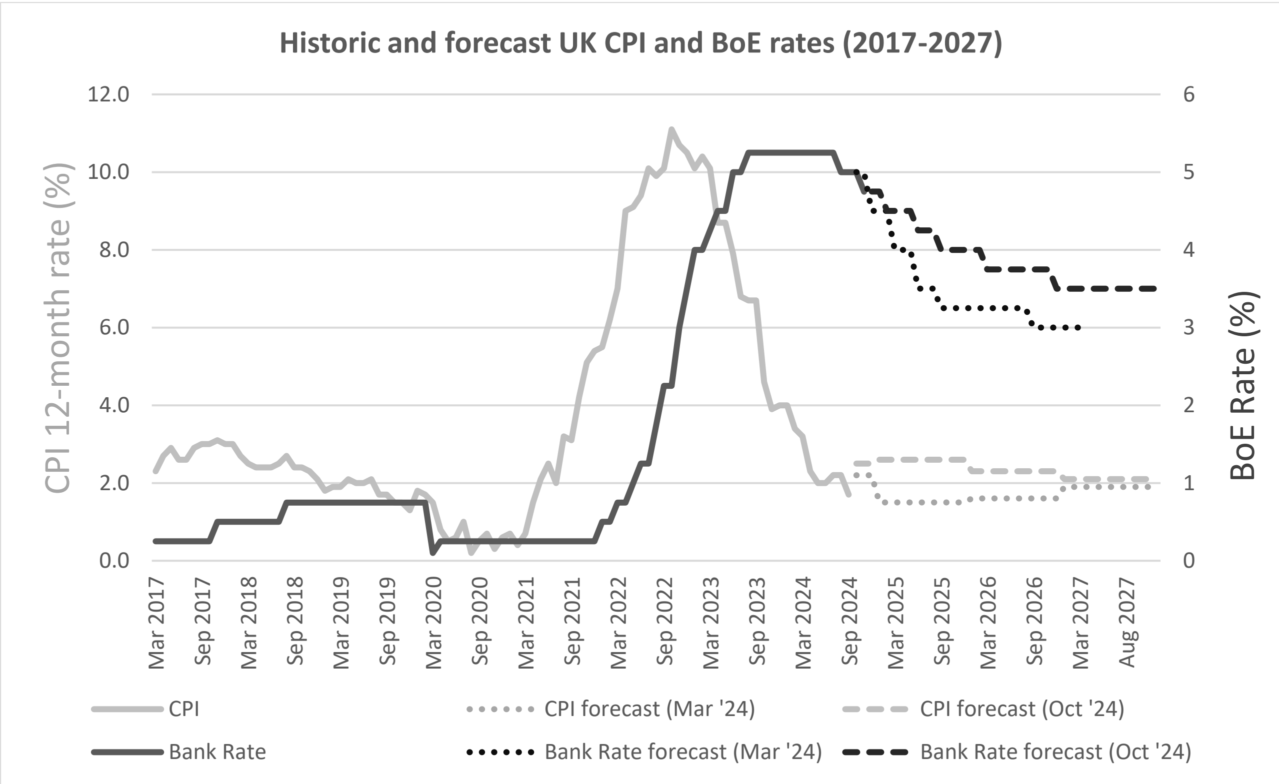
10. More recently, bank rate reduced by 25bps at the November MPC meeting to 4.75%, in line with market expectations. Again, there was just one lone dissenter, with all other MPC members voting unanimously for the change. In the accompanying statement, the Committee repeated the previously held position on

a gradual rate reduction, while it noted that there had been continued progress in disinflation.

11. Looking ahead, there are increased concerns around the future path of inflation following the Autumn Budget. The Bank of England have the CPI measure of inflation hitting 2.5% year-on-year by the end of 2024, 2.7% in Q4 2025, 2.2% Q4 2026, before dropping to 1.8% in 2027. LINK, our treasury management consultants, released a revised interest rate forecast on 11 November following the rate cut by the MPC on 7 November, and they share the Bank of England's view that Autumn budget will be inflationary in the near team. Their forecast is for bank rate to be 50bps – 75bps higher than was previously the case, with bank rate to decline to 4.50% by March 2025, 4.00% by September 2025, and 3.75% by March 2026, where the rate will be maintained until a further decrease by December 2026, leaving rates at around 3.50% in 2027. 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 release.

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 and October 2024) and Bank of England base rate (forecast from LINK) from 2017 to 2027 is shown below in Figure 3.

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



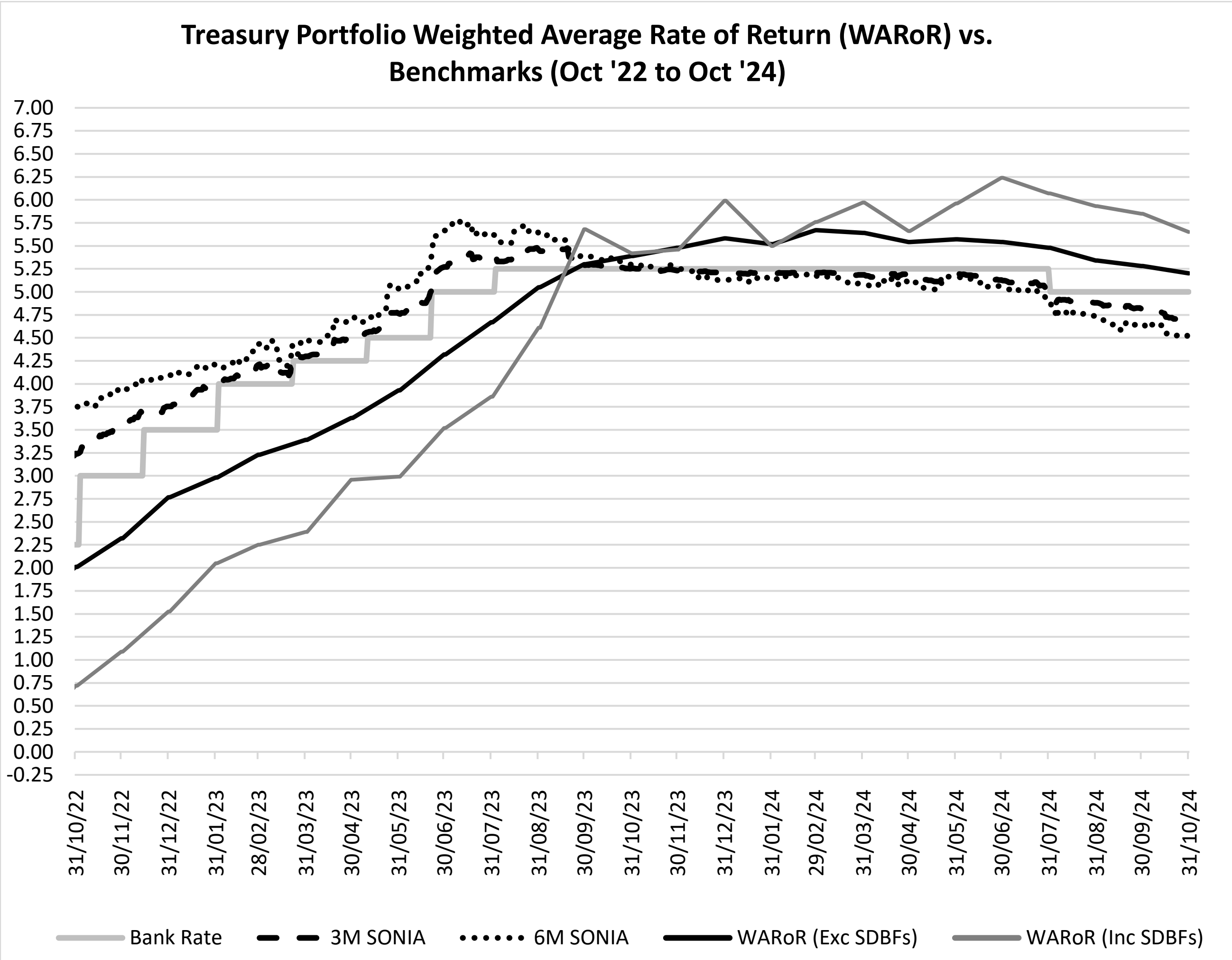
13. As the Bank Rate is the primary determinant of short-term interest rates in the UK, these changes impact the treasury investment portfolio, broadly in two ways:

   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. Post the exit of the then Prime Minister (Liz Truss) in October 2022, Sterling money market rates have continued to trend upwards in line with expected Bank Rate increases as the MPC moved to try and ease inflation as shown in Figure 4 for 3-month and 6-month Sterling Overnight Index Average Rate (SONIA). The

Bank Rate reached a peak of 5.25% at the start of August 2023, and 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.

16. 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 initiated 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%, and further cut to 4.75% in November 2024 following the Autumn Statement and US Presidential Election.

17. Returns on the Corporation's short term investment portfolio excluding short dated funds and are now trending downwards as the restrictive monetary policy is eased, as higher yielding deposits mature and are replaced with new investments. 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). Officers expect this trend 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.

18. 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 October 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.

19. 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. With stronger economic data pointing much more towards a "soft landing" and inflation cooling bond markets calmed and stock markets rallied hard, however bond volatility picked up again in October with policy announcements including the new government unveiling net fiscal loosening in their first budget (i.e. an expansionary budget with spending going up by more than taxes).

20. 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 October 2024

Fund	1 Month Return (31/09/2024 to 31/10/2024)	2 Month Return (31/08/2024 to 31/10/2024)	12 Month Return (31/10/2023 to 31/10/2024)
Federated Hermes Sterling Cash Plus Fund	0.39%	0.82%	5.37%
Aberdeen Standard Liquidity Fund Ultra Short Duration Sterling	0.40%	0.81%	5.61%
Payden Sterling Reserve Fund	0.11%	0.59%	5.90%
L&G Short Dated Sterling Corporate Bond Index Fund	-0.29%	0.33%	8.03%
Royal London Investment Grade Short Dated Credit Fund	-0.31%	0.54%	8.86%

21. 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, has had a positive effect on these short dated bond funds total returns over the last 12 months.

22. 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.

23. 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.

24. 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 4.84% and 4.10% respectively as at the end of September 2024. The interest from these investments is distributed quarterly for Royal London and half yearly for L&G.

<u>Interest on average cash balances</u>

25. 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 October 2024

	2024/25 Original Budget	2024/25 Forecast Outturn	2024/25 Better / (Worse)
	£'000	£'000	£'000
City Fund	**28,900**	**42,755**	**13,855**
City's Estate	**(770)**	**1,405**	**2,175**
Total City Fund & City's Estate Interest on average cash Balances	**28,130**	**44,159**	**16,029**

26. Income from interest on *average cash balances* is currently forecast to exceed budget by £16.0m, 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 28 below the cashflow forecast is currently being finalised post the Resource Allocation Sub Committee (RASC) held the end of October 2024.

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

Cash Flow Forecast

28. The City Fund's medium-term cash flow forecast is currently being finalised 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 ratification of this advice at the Resource Allocation Sub Committee (RASC) held at the end of October 2024 the cashflow is being finalised.

Conclusion

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

30. Since the Investment Committee last reviewed the treasury position as at 31 October 2024, the Bank of England's Monetary Policy Committee (MPC) voted to maintain interest rates at 5.00% at its September meeting, and more recently voted to cut interest rates from 5.00% to 4.75%% at its November meeting. The markets view is that a further rate cut will occur over the remainder of 2024/25, with LINK, our investment consultants, currently forecasting a decrease to 4.50% by March 2025.

31. 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.

32. 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 October 2024
- Appendix 2: Monthly Investment Analysis Review October 2024
- Appendix 3: Treasury Management Counterparties 2024/25: Economic, Social & Governance (ESG) Checklist

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