City of London Corporation Committee Report

Committee(s): Investment Committee – For Information Audit and Risk Management Committee – For Information	**Dated:** 2 December 2024 3 February 2025
Subject: Mid-Year Treasury Management Review 2024/25	**Public report:** For Information
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
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Summary

The Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy for 2024/25 was approved by the Investment Committee and the Finance Committee in February 2024 and by the Court of Common Council on 7 March 2024 and came into effect on 1 April 2024.

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 a mid-year review. The main points to note are as follows:

- The strategy has been reviewed to take account of economic and market developments over the first half of the year, particularly with regard to changes in interest rate expectations.
- The annual Consumer Prices Index (CPI) was 2.3% in April 2023, falling to 2.0% in May, rebounding marginally to 2.2% in July and August as expected, due to energy prices, before falling to 1.7% in September. With headline inflation lower, the Bank of England's Monetary Policy Committee (MPC) initiated its loosening cycle in August 2024 with a 25bps Bank Rate cut from 5.25% to 5.00%, and this

rate was maintained at the September meeting. More recently, following the Autumn Statement and the US Presidential Election, the MPC continued its loosening cycle with a 25bps Bank Rate cut to 4.75% at its November meeting in line with market expectations. The revised path for interest rates over the medium term provided by Link Asset Services forecasts the Bank Rate to be 50bps - 75bps higher than forecast in May 2024, with an expected decline to 4.50% by March 2025 and 3.75% by March 2026, where the rate will remain until a further decrease to 3.50% by December 2026 where it will plateau.

- Under this scenario of falling interest rates, investment returns as a whole are expected to decrease over the rest of the financial year and the medium term, though less aggressively than previously forecast, as maturing investments are reinvested at reduced rates. However, as yields decrease, the capital value of the Corporation's (City Fund) bond fund investments increase as bond prices have an inverse relationship with interest rates (i.e. when interest rates decrease, bond prices increase and vice versa), and hence the capital value appreciates, and total returns during the period have increased.
- As at 30 September 2024, the City had cash balances totalling £1,151.8m. Most of the balances are held for payment to third parties or are restricted reserves. Cash balances are expected to reduce meaningfully over the medium term as spending on the capital programme increases.
- In light of the above, the Corporation's priorities remain as security and liquidity (ahead of yield). Given the current risk environment, officers do not recommend that the Corporation relaxes its risk appetite for the remainder of the year.
- No approved counterparty limits were breached during the first half of 2024/25 and the City has experienced no liquidity concerns.
- No external borrowing has been entered into by City Fund and it is not anticipated that City Fund will require any external borrowing during the remainder of the financial year.

Recommendation(s)

Members are asked to note the report.

Main Report

Background

1. The City of London Corporation (the City) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the City's low risk appetite, providing adequate liquidity initially before considering investment return.

2. The second main function of the treasury management service is the funding of capital expenditure plans. In September 2019 the City issued fixed rate market debt on behalf of City's Cash via a private placement, which will support that

entity’s long term capital financing plans. The first tranche of borrowing proceeds of £250M were received in September 2019. The second tranche of borrowing proceeds of £200M were received in July 2021. The City has not undertaken any new borrowing in the first half of this year and does not at this stage anticipate any external borrowing in the remainder of 2024/25.

3. The City’s treasury management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised 2021) which was adopted by the Court of Common Council on 3 March 2010.

4. The City defines its treasury management activities as:

   The management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Economic Update

5. UK headline consumer prices inflation (CPI) remained around the Bank of England’s (BoE) 2.0% target, falling from an annual rate of 2.3% in April 2023 to 2.0% in May, rebounding marginally to 2.2% in July and August as expected, due to energy prices, before falling to 1.7% in September. With headline inflation lower, the BoE’s Monetary Policy Committee (MPC), with a 5-4 vote, initiated its loosening cycle in August 2024 with a 25bps interest rate cut from 5.25% to 5.00%.

6. The Bank Rate was maintained at 5.00% at the September MPC meeting, in line with market expectations, at an 8-1 vote 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."*

7. More recently, following the Autum Statement and the US Presidential Election, the MPC continued its loosening cycle with a 25bps interest rate cut to 4.75% at its November meeting in line with market expectations, at an 8-1 vote, with one voting for an increase to 5.0%. 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.

8. Over the period (1 April to 31 September), the UK 10-year gilt yield declined from 4.32% in May 2024 to 4.02% following the Bank Rate cut in August 2024, though the market response was muted following the decision to hold the Bank Rate at 5.00% in September, with the 10-year yield rising by only 5bps after the announcement – likely as markets had priced in a 25% chance of a rate cut prior to the meeting. The sentiment in the near term is a possible rise in Gilt yields as UK policymakers remain cautious due to persistent inflation concerns.

9. According to the Office for National Statistics (ONS) Gross Domestic Product (GDP) grew by 0.6% in the quarter April to June 2024 following a 0.7% expansion in the first three months of the year. However, the economy stagnated in July with no growth, largely as a result of a sharp drop in manufacturing output which was not conducive of the new Labour Government's plan to accelerate the pace of growth. However, whilst there was 0.2% GDP growth in August with all three main sectors, services, production, and construction expanding by 0.1%, 0.5% and 0.4% respectively, growth remained sluggish.

10. Looking ahead, following the Policy Announcements in the Autumn Statement, including the anticipated major investment in the public sector, according to the Bank of England this is expected to lift UK real GDP to 1.7% by 2025 before growth moderates in 2026 and 2027. However, whether the Government's polices lead to a material uptick in growth primarily focuses on the logistics of fast tracking planning permissions, identifying sufficient skilled labour to undertake a resurgence in building, and an increase in the employee participation rate within the economy.

11. Additionally, there are increased concerns around the future path of inflation following the Autumn Budget and the outcome of the US Presidential election on 6 November. The introduction/extension of US tariffs following the US presidential election, as well as further tax cuts and an expansion of the current US budget deficit, may prove inflationary, with any change in US Treasury yields likely to impact UK gilt yields. 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.

12. The increasing uncertainties of the Middle East may also exert an upward pressure on inflation, with oil prices rising in the aftermath of Iran's missile attack on Israel on 1 October. China's outpouring of new fiscal support measures in the latter stages of September has also added to the upshift in broader commodity prices, which, in turn, may impact on global inflation levels and thus monetary policy decisions.

Treasury Management Strategy Statement and Annual Investment Strategy Update

13. The Treasury Management Strategy Statement and Annual Investment Strategy for 2024/25 was approved by the Investment Committee (12 February 2024), the Finance Committee (20 February 2024) and the Court of Common Council (7 March 2024).

14. Having considered the strategy, officers believe that it remains appropriate for the second half of 2024/25 and do not recommend any fundamental changes are made.

<u>Investment Strategy</u>

15. The Corporation held £1,151.8m of investments as at 30 September 2024 (£901.2m at 31 March 2024). Most of the balances are held for payment to third parties or are restricted reserves; they also include debt issued by City's Cash in 2019/20 and in the first half of 2021/22. As the Corporation's capital programme

progresses, cash balances are projected to decline as internal borrowing increases (see paragraph 27 below). The weighted average rate of return on the City's treasury management portfolio at the end of September was 5.85%.

16. The weighted average rate of return was boosted by the short-dated bonds (i.e. *non-specified investments*) as their 12 month-trailing returns reached over 9% at the end of September 2024 (the weighted average rate of return excluding short-dated bonds funds was 5.28%). 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 increase in short-dated bond fund returns, as a year earlier interest rates had just reached a peak of 5.25% as the Bank of England continued its restrictive monetary policy to ease inflationary pressures, and as interest rates then plateaued and have now begun to decrease the total returns during the period increased.

17. As non-specified investments, only the City Fund will have exposure to the short-dated bond funds (as ratified by the Court of Common Council in December 2022), and as the IFRS9 override is still in place, any capital gains/losses will continue not to be taken through the General Fund.

18. In accordance with the CIPFA Treasury Management Code of Practice, the Corporation's investment priorities are:
    - Security of capital
    - Liquidity
    - Yield

19. The Corporation aims to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Corporation's risk appetite. In the current economic climate, it is considered appropriate to retain sufficient capacity to cover planned and potentially unanticipated cash flow needs, but also to seek out value by placing deposits with high credit rated counterparties where possible. The current investment strategy remains appropriate for facilitating these aims by limiting lending to only high-quality borrowers whilst also not being so restrictive as to create an overconcentration of exposure to any single counterparty.

20. At the outset of the year, the Corporation estimated the Bank Rate to have peaked at 5.25%, where it would remain until the second half of 2024, then incrementally reduce to 3.00% in the second half of 2025. Since the original strategy was written inflation has remained "sticky", and the larger than expected overall package in the Autumn budget and the potential impact it could have on growth and inflation in the coming years has seen markets dial back their rate cut expectations.

21. Prior to the Autumn budget and the MPC's November meeting, the revised path for interest rates over the medium term provided by Link Asset Services forecast the Bank Rate to decline to 4.00% by March 2025 and 3.25% by September 2025, where the rate would be maintained until a further decrease by September 2026, leaving rates at around 3.00% for the rest of the 2026/27 financial year.

22. Following the Autumn budget announcement, the outcome of the US Presidential election on 6 November, and rate cut by the MPC on 7 November, Link Asset Services released a further revised interest rate forecast on 11 November. In summary, the Bank Rate is now forecast to be 50bps – 75bps higher than was previously the case. Their view is that the policy announcements in the Autumn budget will be inflationary in the near team.

23. The latest Link Asset Services forecast now projects the Bank Rate will decline to 4.50% by March 2025, 4.00% by September 2025, and 3.75% by March 2026, where the rate will maintain until a further decrease by December 2026, leaving rates at around 3.50% in 2027 (see Appendix 1). Under this scenario, investment returns as a whole are still expected to decrease over the rest of the financial year and the medium term, though less aggressively than previously forecast.

24. Any movement below a 4.00% Bank Rate will be dependent on inflation data in the second half of 2025. Though bank rates are forecast to fall back over the next two to three years as inflation dampens, key risks to the Bank Rate forecast at present from domestic and international factors include:

    - Inherent risks in the public sector investment by the UK Government which are expected to be inflationary in the near term, but may lead to an increased prospect of further government borrowing and tax rises, along with tepid GDP performance if progress is blocked;
    - If US policy follows the key policies set out in the presidential campaign, in particular the threat of implementing tariffs on goods and services coming into the US, this would likely have an inflationary impact across the global economy, and hence lead to interest rates remaining higher for longer; and.
    - Continuing geo-political risks, in particular in Eastern Europe and the Middle East.

25. In light of the above, the prime objective is to ensure cash is safe and available when needed, and the Corporation's priorities remain as security and liquidity, ahead of yield. It is not recommended that the Corporation relaxes its creditworthiness criteria at this stage to protect income as this would contradict the primary obligation of keeping the Corporation's cash assets secure, before considering yield.

26. No approved counterparty limits were breached during the first half of 2024/25 and the City has experienced no liquidity concerns. During the year, a new counterparty was onboarded, Standard Chartered Bank. The Treasury Management Strategy remains appropriate in enabling the City to pursue its prime objectives of security and liquidity, followed by yield.

<u>Borrowing Strategy</u>

City Fund

27. The City Fund has not acquired any external borrowing in the first half of the year and it is not anticipated that any external borrowing will be required in the remainder of 2024/25.

28. Although the City Fund is forecast to have a growing capital financing requirement forecast in the years ahead, it expects to be able to fund this in the short term via internal borrowing. Entering into new external borrowing now would increase the Corporation's revenue pressures in the immediate term (i.e. there would be a cost of carry).

City's Cash

29. City's Cash issued £450m of market debt in 2019/20, £200m of which was deferred for receipt until 2021/22. The Corporation took receipt of these borrowing proceeds in July 2021 and they were held in the short term investments portfolio until required by the capital programme. By deferring receipt of this borrowing until 2021, the City avoided paying additional interest costs whilst at the same time securing fixed rate borrowing on competitive terms. There are no plans to undertake any further borrowing on behalf of City's Cash in the second half of the year at this stage, but this will be monitored by officers as the Medium term Financial Plan (MTFP) is finalised.

Conclusion

30. The City has effectively executed the 2024/25 Treasury Management Strategy during the first six months of the year considering the original strategy against the current treasury management environment, officers judge that the investment strategy remains appropriate for the second half of the year.

Appendices

- Appendix 1 – Interest Rate Forecasts 2024/25 – 2027/28

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APPENDIX 1: Interest Rate Forecasts 2024/25 – 2027/28

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Please note, the lower Housing Revenue Account PWLB rate started on 15 June 2023 for those authorities with an HRA (standard rate minus 60 bps)and followng the Autumn Statement, tha availabilty of this rate has been extended to the end of June 2025.

Link Group Interest Rate View	11.11.24												
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30

<u>Comparison of Link Group current November 2024 interest rate forecast vs May 2024 forecast</u>

Bank Rate	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
11.11.24	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
28.05.24	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00	-	-	-
Change	0.25	0.50	0.75	0.75	0.75	0.50	0.50	0.75	0.50	0.50	-	-	-