



Arlingclose Ltd:
Independent treasury management services

Treasury Management for Elected Members

North East Derbyshire District Council

2nd February 2017

Cecilie Booth, Client Director

Agenda

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 - Role of Elected Members

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 - Security, Liquidity and Yield

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 - Financial Market Conditions
 - Interest Rate Forecast
 - Bank Regulation

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 - Comparison with Other Local Authorities

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-

The Framework for Local Authority Treasury Management

Definition of Treasury Management

Management of the Council's

- Cash flows
- Banking arrangements
- Investments
- Borrowing

Effective control of the associated risks

- Credit risk - non-repayment or other default by another party
- Liquidity risk - inability of the Council to make payments
- Market risks - unplanned changes in interest rates, bond prices, etc

Pursuit of optimum performance

- Maximum value for money
- But within the context of effective risk management

Legislation and Regulation

Local Authorities MAY:

- invest or borrow money:
 - for any purpose relevant to their functions
 - for prudent financial management
- do anything that individuals generally may do

Local Authorities MUST:

- set an affordable borrowing limit each year
- have regard to CLG and CIPFA guidance

Local Authorities MUST NOT:

- exceed their affordable borrowing limit
- borrow in foreign currency
- mortgage their property as security for loans borrowed

CLG Investment Guidance

- prepare an Investment Strategy each year,
- give priority to security, liquidity and yield
- place limits on higher risk investments

CIPFA Treasury Management Code

- maintain suitable policies and practices
- present three reports a year to full Council

CIPFA Prudential Code for Capital Finance

- Ensure that capital expenditure plans are:
 - prudent in meeting service needs and providing value for money
 - affordable in terms of acceptable Council Tax levels
 - sustainable over the long-term - requiring asset management plans

Role of Elected Members

Full Council

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Receiving mid year report

Responsible body - Cabinet

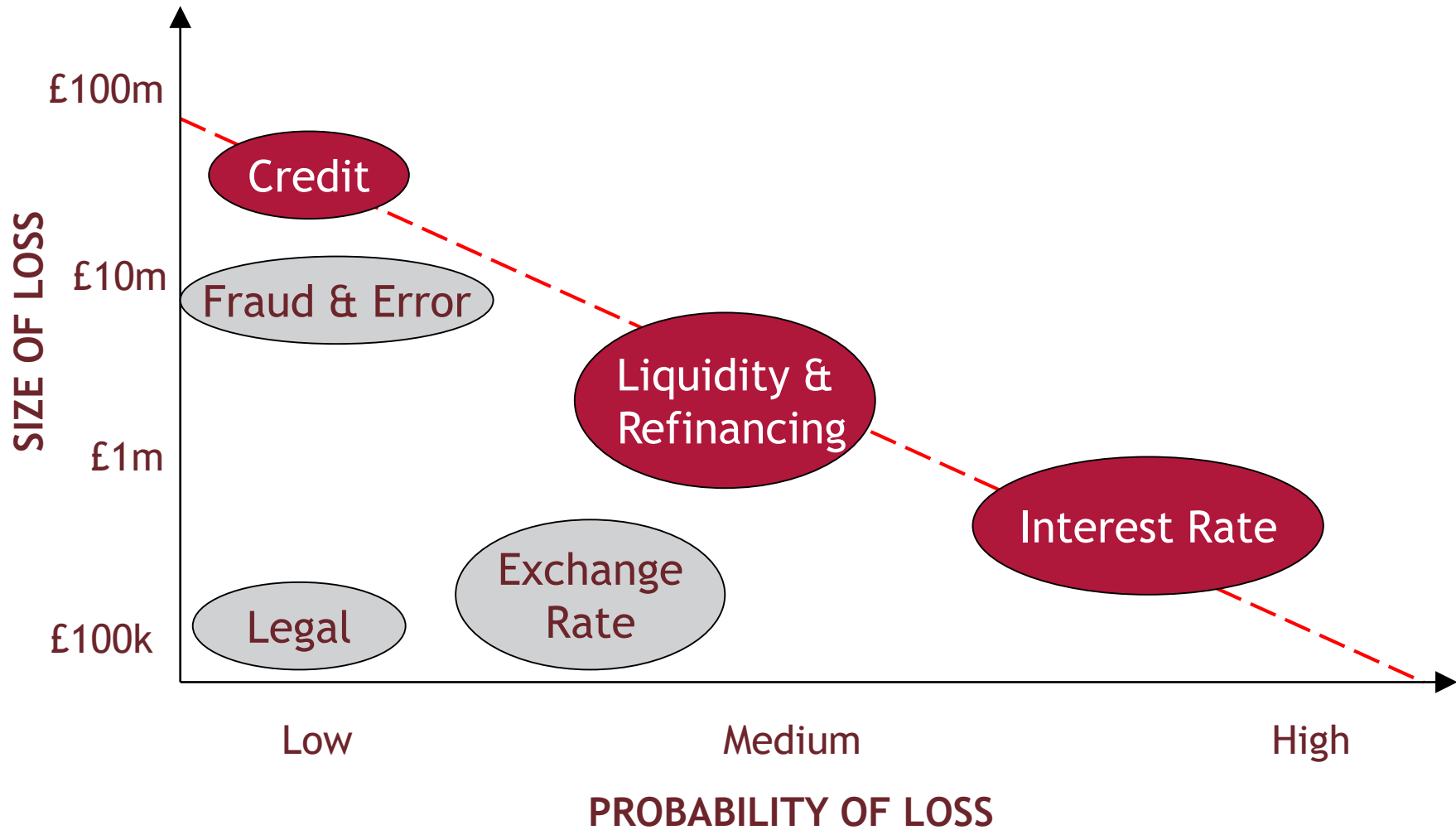
- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Receiving and reviewing regular monitoring reports and acting on recommendations

Responsibility for scrutiny - Audit Committee

- Reviewing the treasury management policy and procedures
- Making recommendations to the responsible body.

Risk and Reward

Treasury Management Risks



Credit Risk

Credit Risk

- The risk that investment counterparties fail to repay principal and interest when due

Credit Ratings

- Opinion on the relative chance of default
- Internationally recognised scales:

F1+	F1	F2	F3	B	C	D
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AAA	AA	A	BBB	BB	B	CCC	CC	C	D
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- Investment and speculative grades
- Thorough analysis of the borrower
- But slow to react to fast moving events

Agency	ST rating	LT rating
Fitch	F1	A
S&P	A-1	A
Moody's	P-1	A2

- Exception made for RBS (BBB+)
- Minimum sovereign rating of AA for countries

Credit Default Swaps

- Insurance policy traded on financial markets
- Premium reflects chance and size of loss
- Expressed in basis points - 0.01%
- Fast to react, but not as thorough as ratings

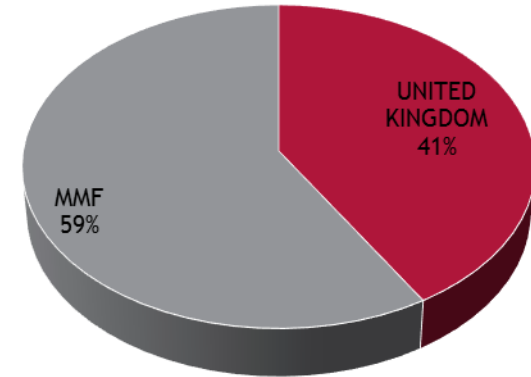
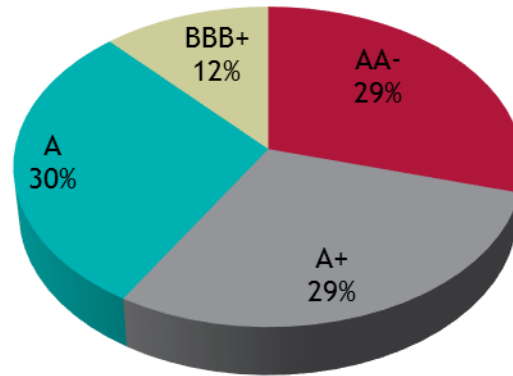
Example Credit Ratings and CDS

Country	Rating	CDS
Canada	AAA	-
Singapore	AAA	-
Germany	AAA	19
Sweden	AAA	22
Netherlands	AAA	25
USA	AA+	25
UK	AA	28
France	AA	41
Spain	BBB	74
Italy	BBB-	166
Greece	CCC-	944

Bank	Rating	CDS
Handlesbanken	AA-	48
Nordea	AA-	53
NAB	AA-	59
HSBC	AA-	65
ING	A	61
Lloyds	A	66
Barclays	A-	76
RBS	BBB+	100
Deutsche	BBB	160
Monte dei Paschi	B-	386
Bank of Cyprus	CCC	-

North East Derbyshire DC Credit Risk as at 31st December

Total Portfolio : £17.0m
Total Return : 0.19%



Counterparty	Type of Investment	Principal	Start Date	Effective Maturity	Rate	Days to Maturity	Days to Next Rate Reset	Moody's Credit Rating	Fitch Credit Rating	S&P Credit Rating	Lowest Credit Rating	Average Credit Score	Country
BANK OF SCOTLAND PLC	CALL ACCOUNT	£ 75		01/01/2017	0.150%	1	1	A1	A+	A	A	5.33	UNITED KINGDOM
LLOYDS BANK PLC	CALL ACCOUNT	£ 1,004,847		01/01/2017	0.150%	1	1	A1	A+	A	A	5.33	UNITED KINGDOM
NATIONAL WESTMINSTER BANK	CALL ACCOUNT	£ 2,020,373		01/01/2017	0.010%	1	1	A3	BBB+	BBB+	BBB+	7.67	UNITED KINGDOM
SANTANDER UK PLC	CALL ACCOUNT	£ 4,020,873		01/01/2017	0.150%	1	1	Aa3	A	A	A	5.33	UNITED KINGDOM
FEDERATED INVESTORS (UK)	MONEY MARKET FUND	£ 5,000,000		01/01/2017	0.242%	1	52	-	AAAmf	AAAm	AA-	4.45	MMF
STANDARD LIFE (FORMERLY IGNIS) LIQUIDITY FUNDS	MONEY MARKET FUND	£ 5,000,000		01/01/2017	0.245%	1	55	-	AAAmf	AAAm	A+	5.07	MMF
Total - Internal Investments		£ 17,046,168			0.19%	1	32				A+	5.27	Value Weighted Average
Investments Exposed to Bail-in	100%	£ 17,046,168									A+	5.27	Time Weighted Average
				Total return	Income only								
Total - Internal Investments	6	£ 17,046,168		0.19%	0.19%							£ 17,046,168	Available within 7 days
Total - External Investments	-	£ -		-	-							£ 17,046,168	Available within 100 days
Total Portfolio	6	£ 17,046,168		0.19%	0.19%								

7 days includes Cash Plus Funds, 100 days also Short Bond Funds

Liquidity and Refinancing Risks

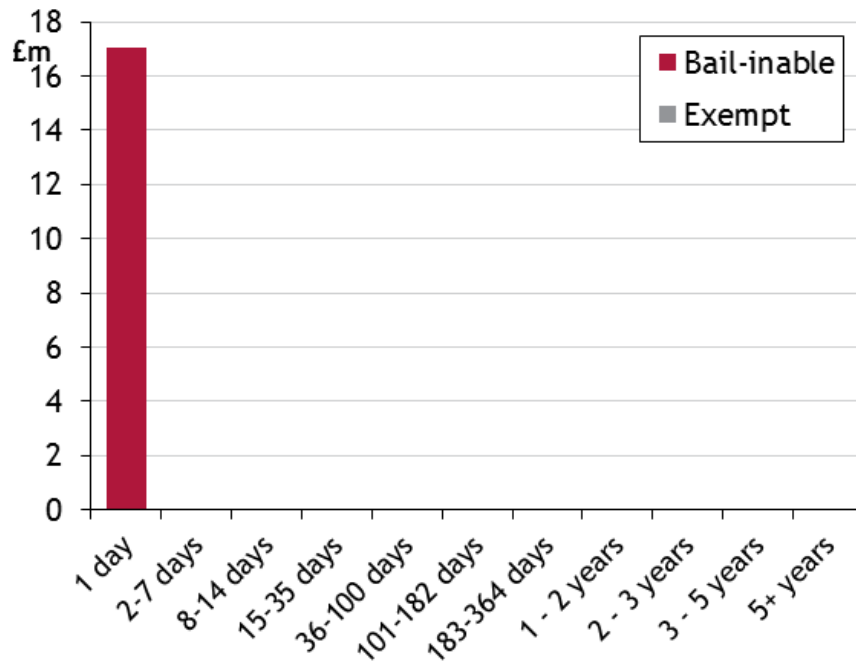
Liquidity Risk

- The risk that cash is not available to meet spending commitments

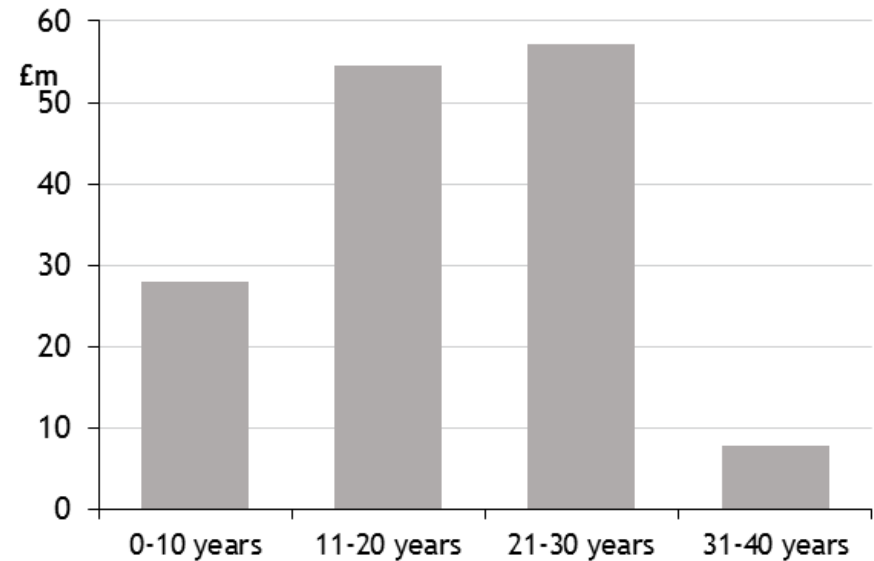
Refinancing Risk

- The risk that loans will need refinancing at a time of high interest rates

Investment Maturity Profile



Borrowing Maturity Profile



Interest Rate Risk

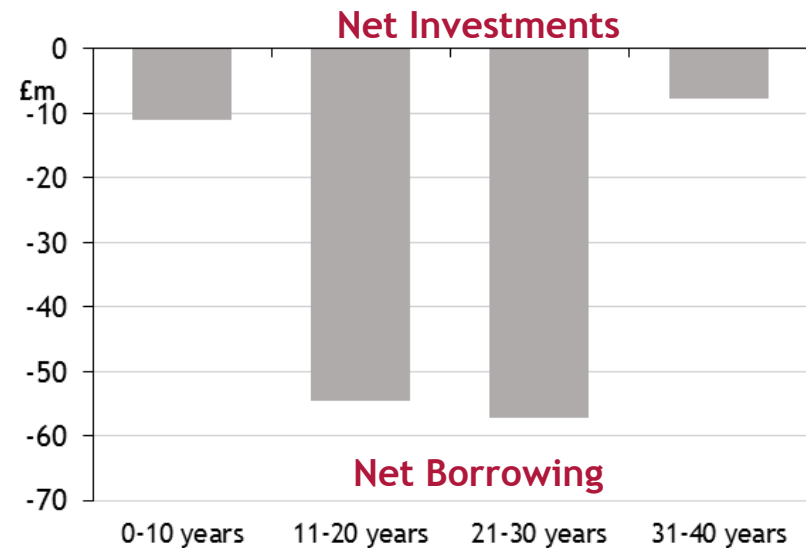
Interest Rate Risk

- The risk that changes in interest rates place an unexpected burden on the revenue account

Effects of rising interest rates

- Short term deposits earn more interest ✓
- Long-term investments fall in value ✗
- Short-term borrowing is more expensive ✗
- Long-term borrowing is cheaper to repay ✓

Exposure to Interest Rates

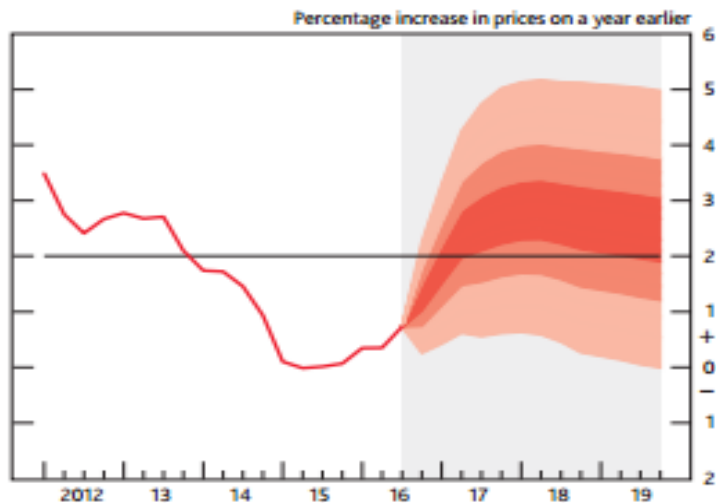


- One year impact of a 1% rise is £0.16m
- Impact will be greater in later years

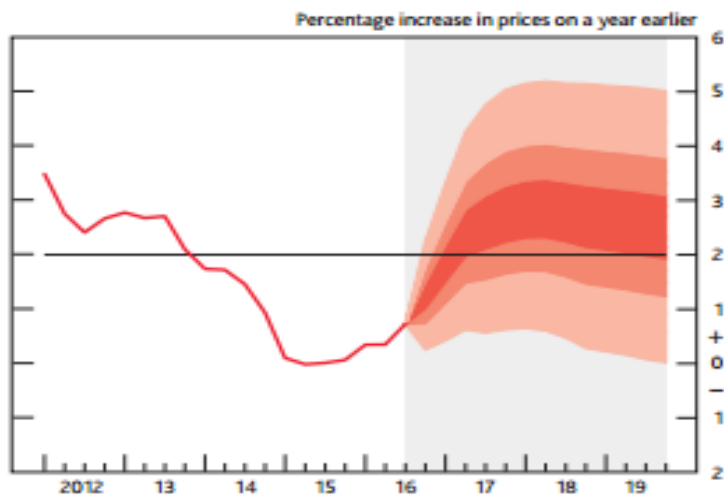
External Context

Bank of England Forecasts - November 2016

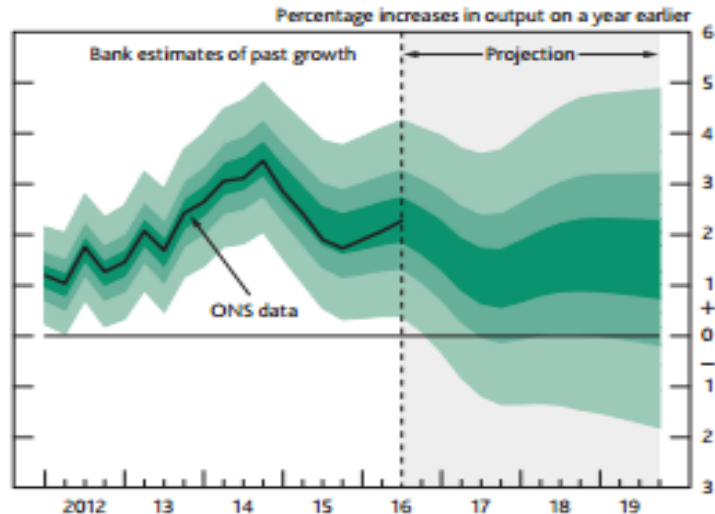
Projection for CPI Inflation
Based on market interest rate expectations



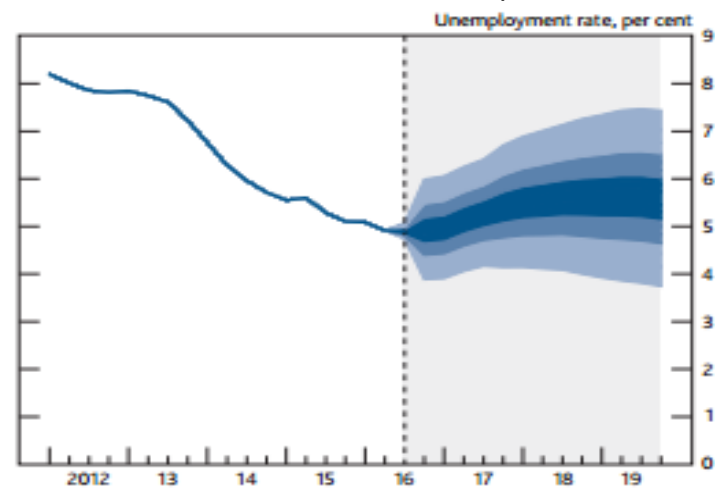
Projection for CPI Inflation
Based on constant 0.25% Bank Rate



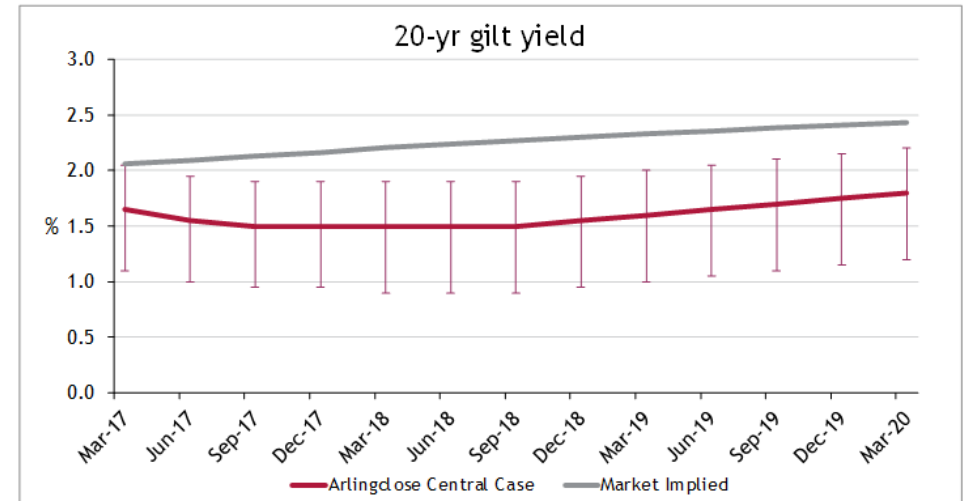
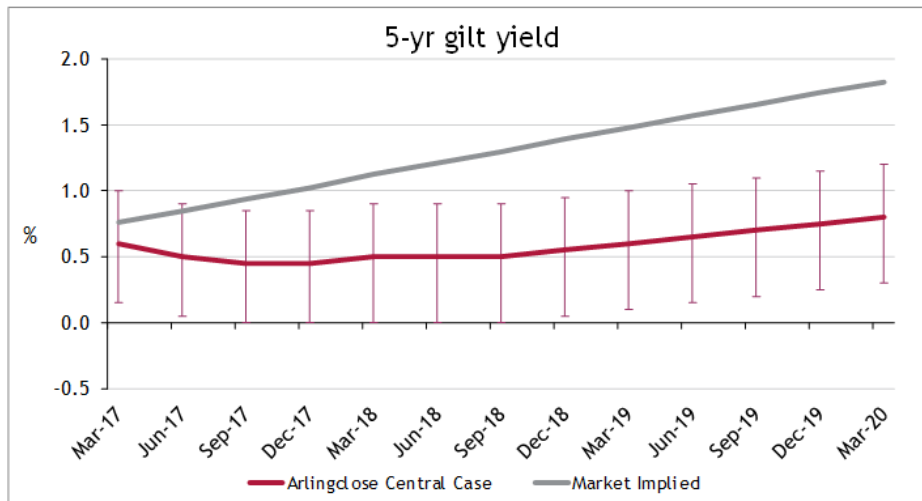
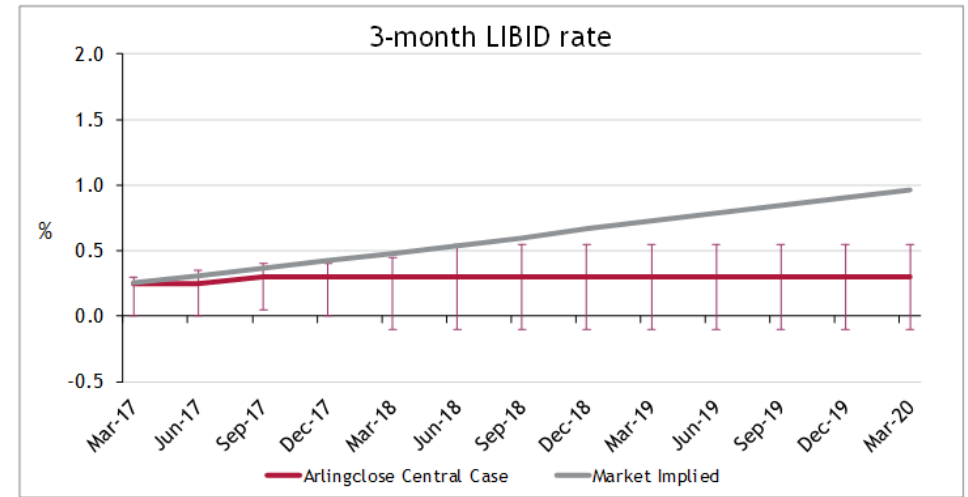
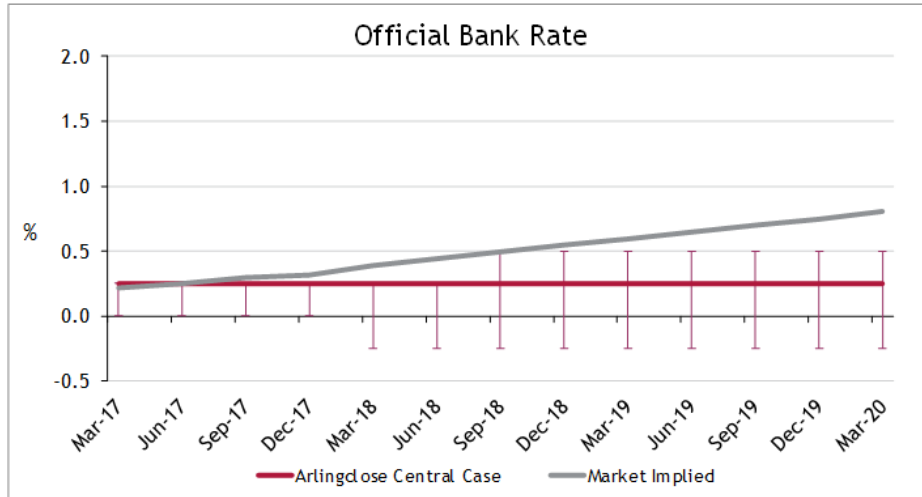
Projection for GDP Growth
Based on market interest rate expectations



Projection for LFS Unemployment Rate
Based on market interest rate expectations



Interest Rate Forecasts - January 2017

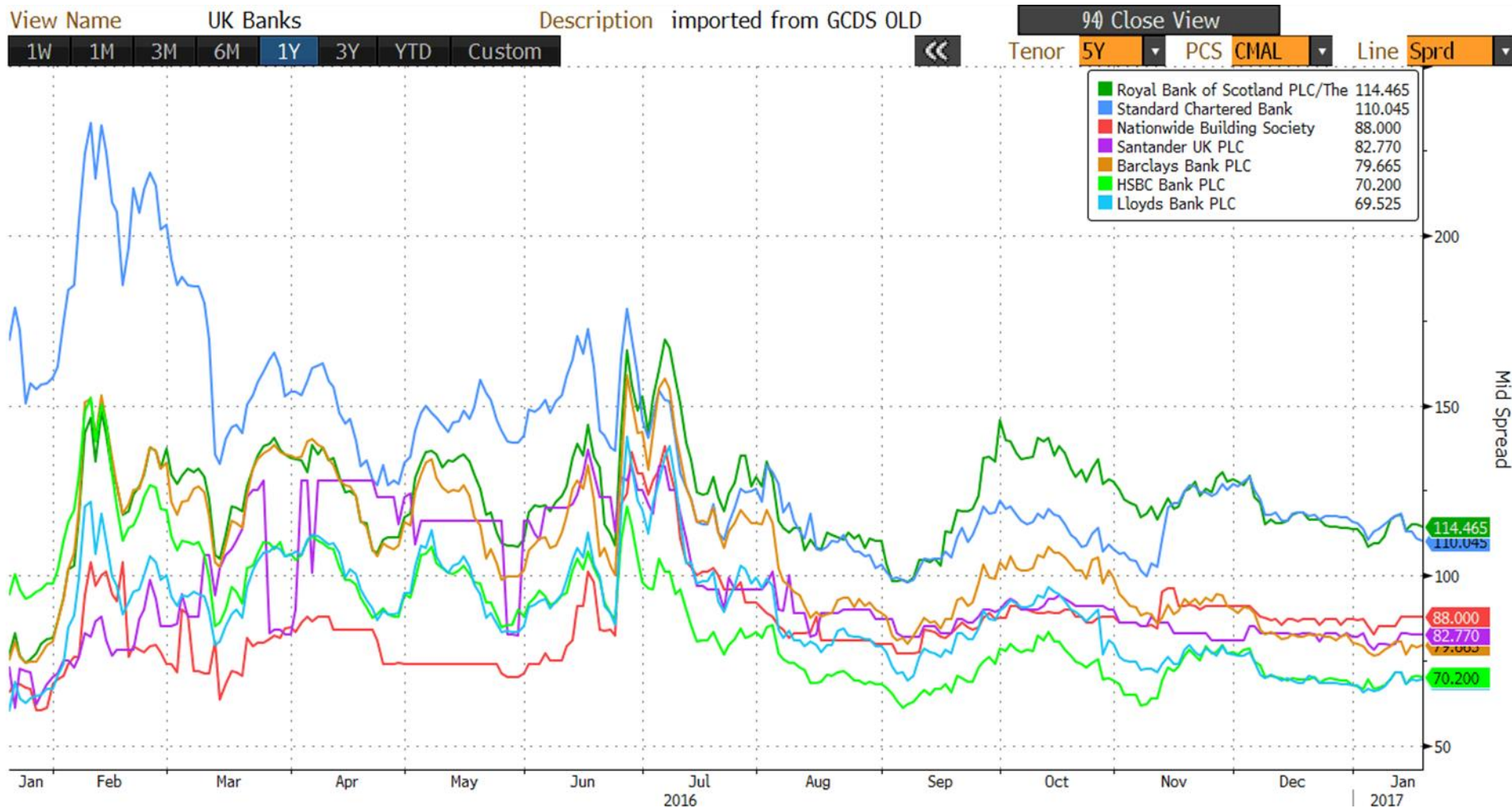


Global Interest Rates

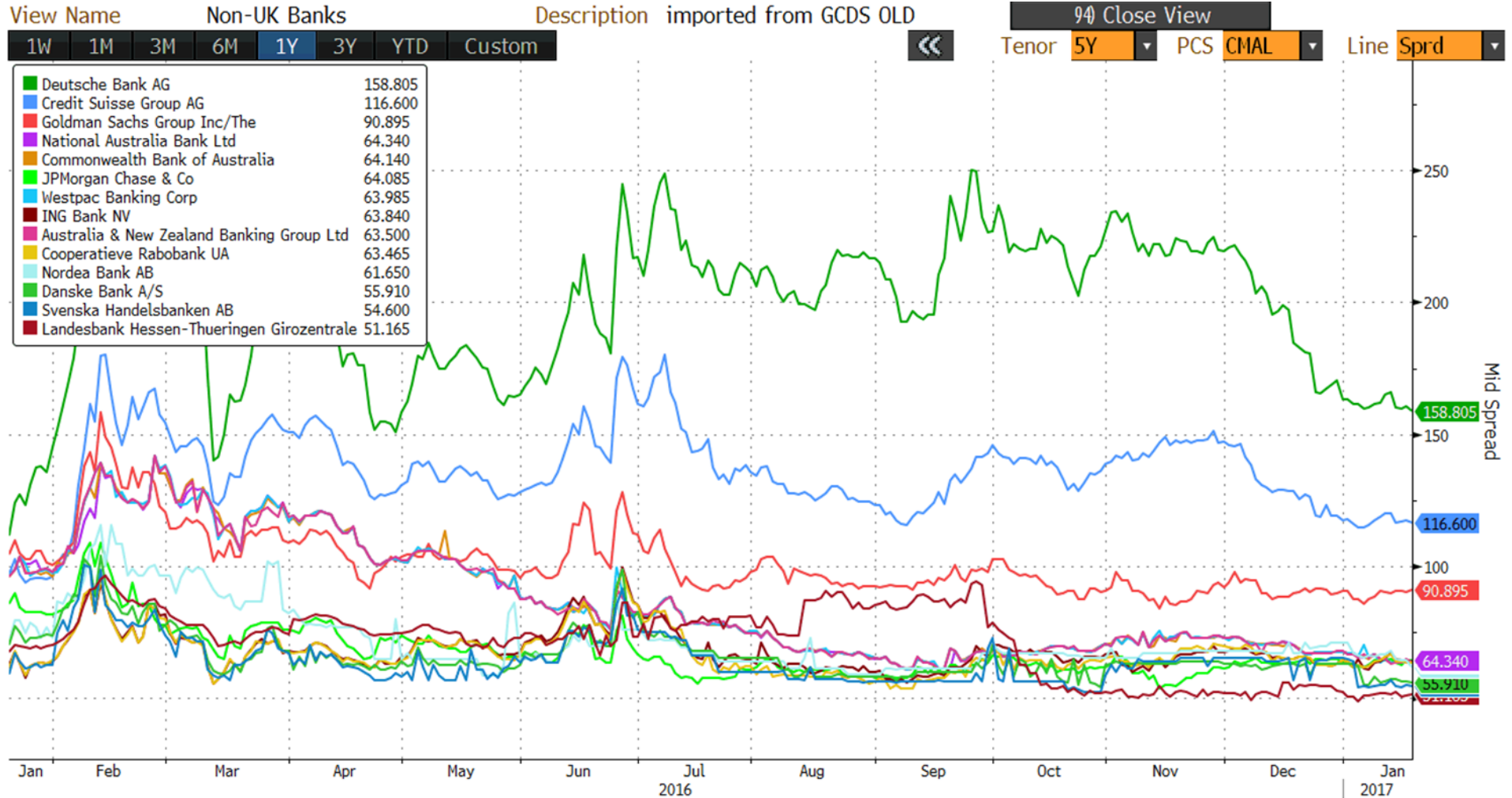
Country	Central Bank Rate	1 year	2 year	5 year	10 year	20 year	30 year
Switzerland	-0.75	-0.86	-0.87	-0.56	-0.08	0.27	0.41
Sweden	-0.50	-0.75	-0.53	0.10	0.77	1.76	--
Germany	0.00	-0.64	-0.68	-0.38	0.44	0.92	1.17
Finland	0.00	-0.52	-0.58	-0.26	0.65	--	1.30
Netherlands	0.00	-0.60	-0.63	-0.17	0.60	1.03	1.28
Italy*	0.00	-0.24	0.06	0.97	2.31	2.94	3.38
Denmark	0.05	--	-0.56	-0.13	0.47	--	1.20
Japan*	0.10	-0.28	-0.23	-0.09	0.09	0.65	0.84
UK	0.25	0.07	0.14	0.62	1.44	1.96	2.07
US	0.75	--	1.20	1.92	2.47	2.80	3.06
Canada	0.50	0.61	0.80	1.13	1.77	2.40	2.42
Norway	0.50	0.54	--	1.10	1.76	--	--
Australia	1.50	1.73	1.82	2.25	2.73	3.49	--
Singapore	N/A	1.06	1.36	1.80	2.38	2.76	2.78

* Japan and Italy are not currently on the Arlingclose approved list but represent the 2nd and 3rd largest bond markets respectively

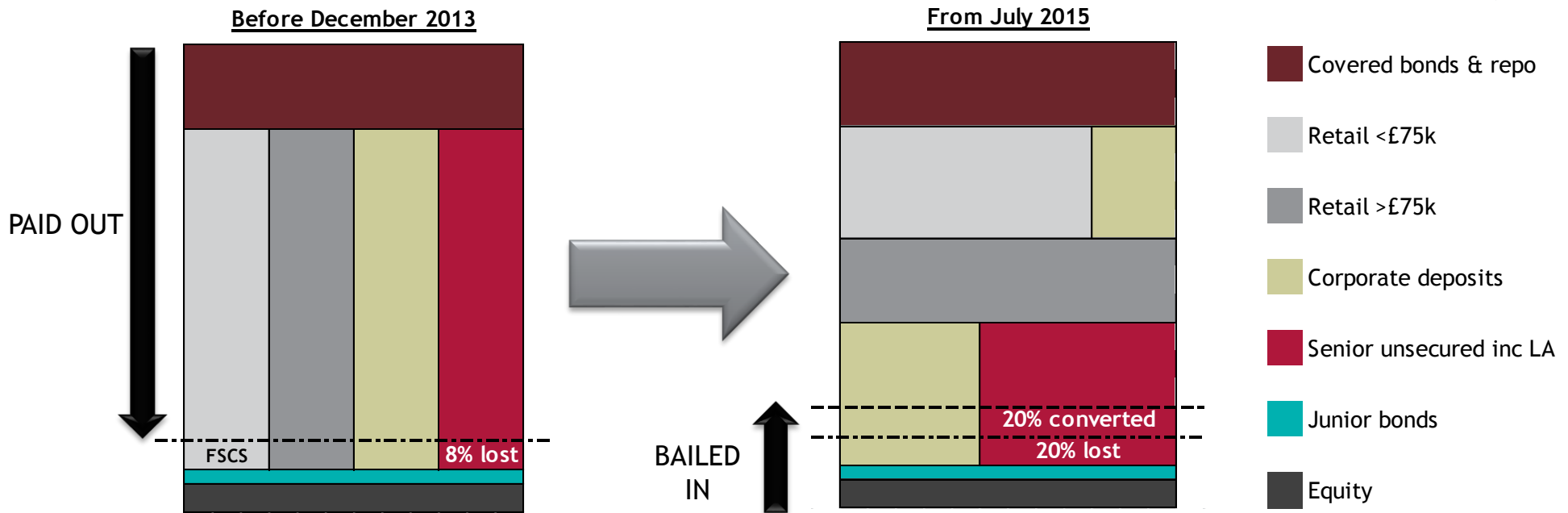
UK Bank CDS



Overseas Bank CDS



From Bail-out to Bail-in



Previously

- Failed banks were either bailed out by government
- Or placed into administration
- With losses shared amongst most investors

Now

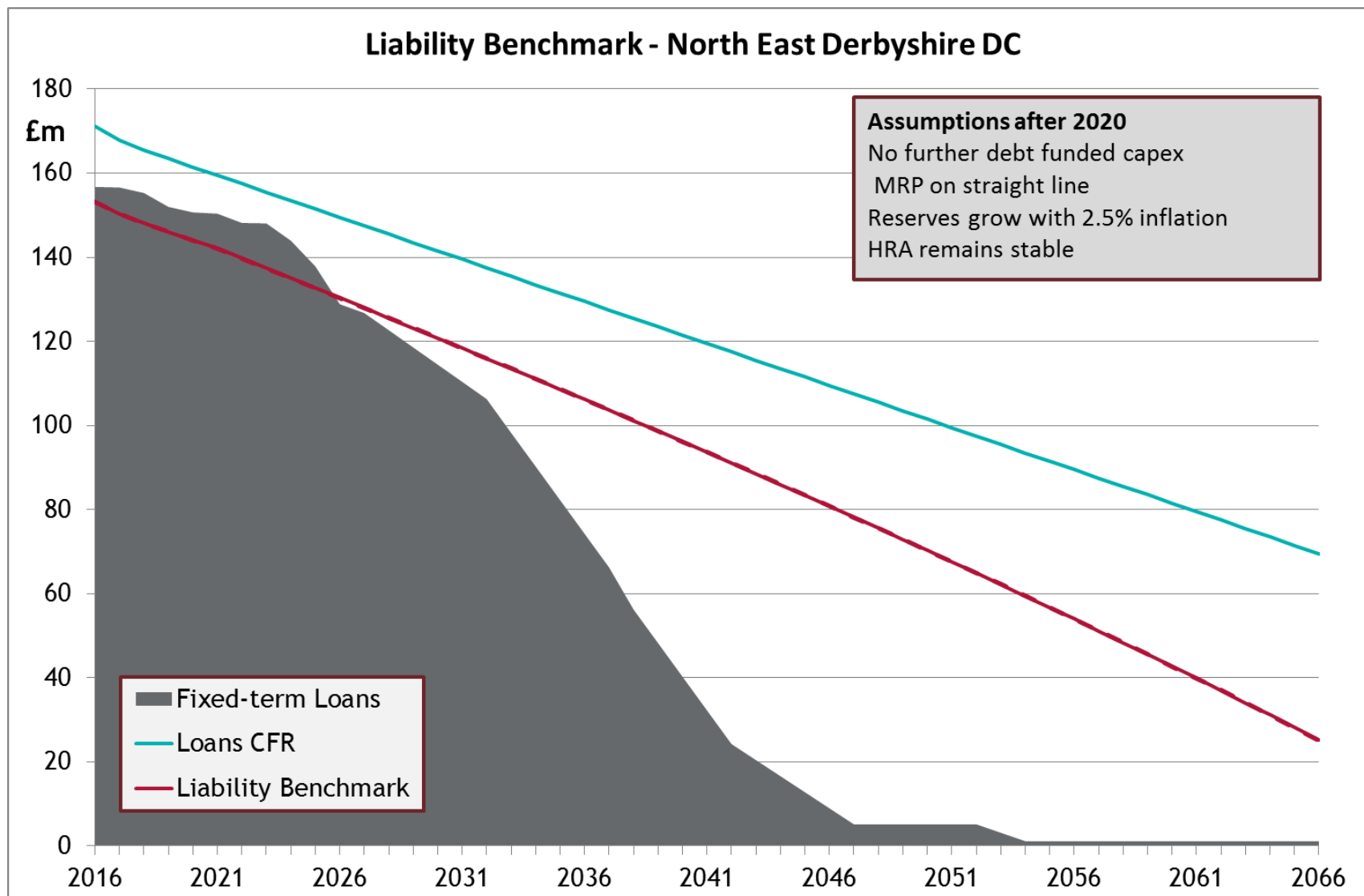
- Failing banks will be bailed in for past and future losses
- Small depositors are protected at the expense of LAs
- Government bail-outs are illegal until after bail-in

Local Context

North East Derbyshire DC Summary Balance Sheet

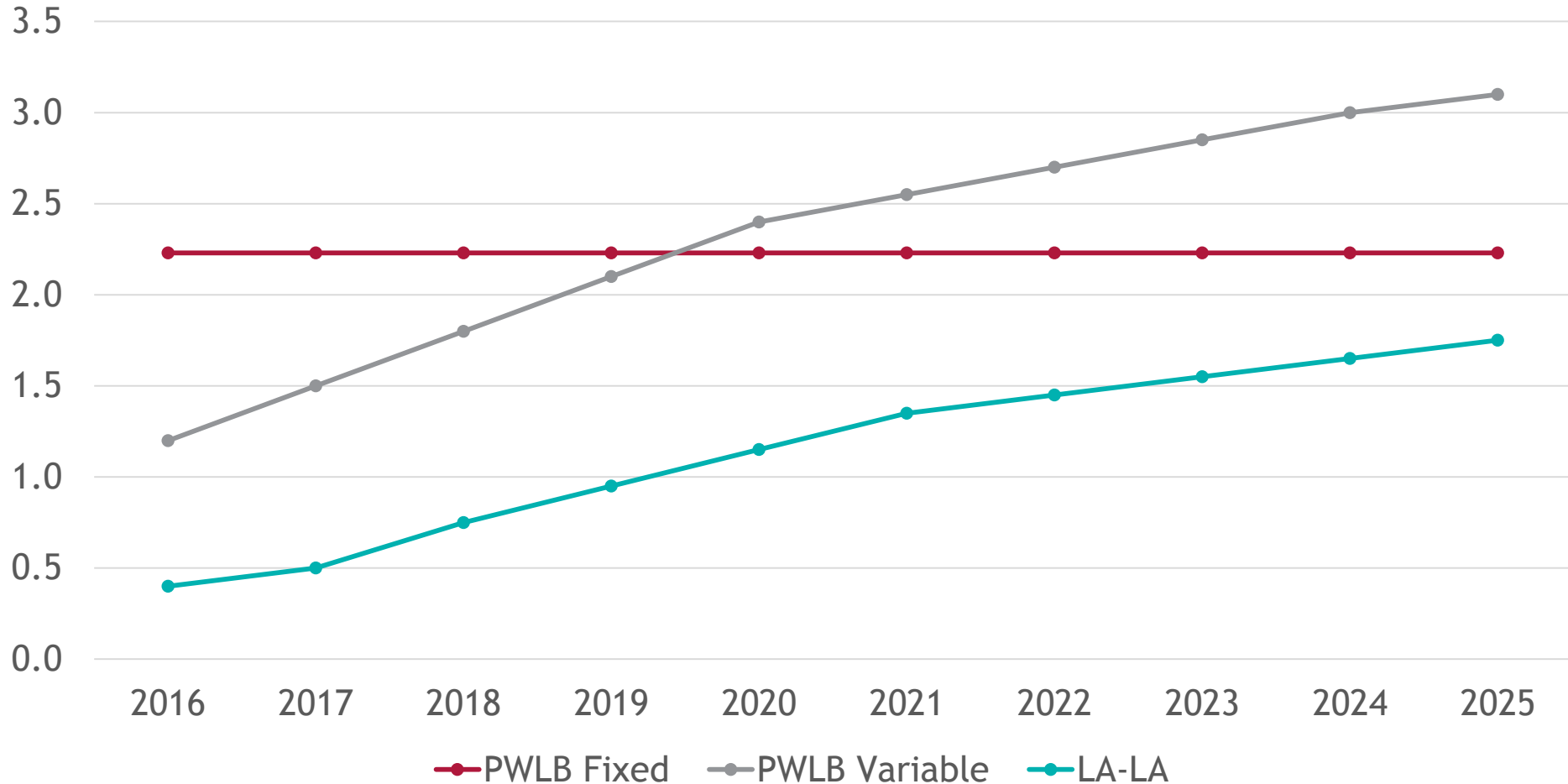
North East Derbyshire DC					
Balance Sheet Summary and Projections in £millions - last updated 31 Mar 2016					
31st March:	2016	2017	2018	2019	2020
Loans Capital Financing Req.	171.1	167.8	165.5	163.5	161.5
Less: External Borrowing	-156.8	-156.6	-155.3	-152.0	-150.7
Internal (Over) Borrowing	14.4	11.2	10.2	11.5	10.8
Less: Usable Reserves	-14.9	-14.4	-14.4	-14.4	-14.4
Less: Working Capital Surplus	-3.0	-3.0	-3.0	-3.0	-3.0
Investments / (New Borrowing)	3.5	6.2	7.2	5.9	6.6

Long-term Forecast

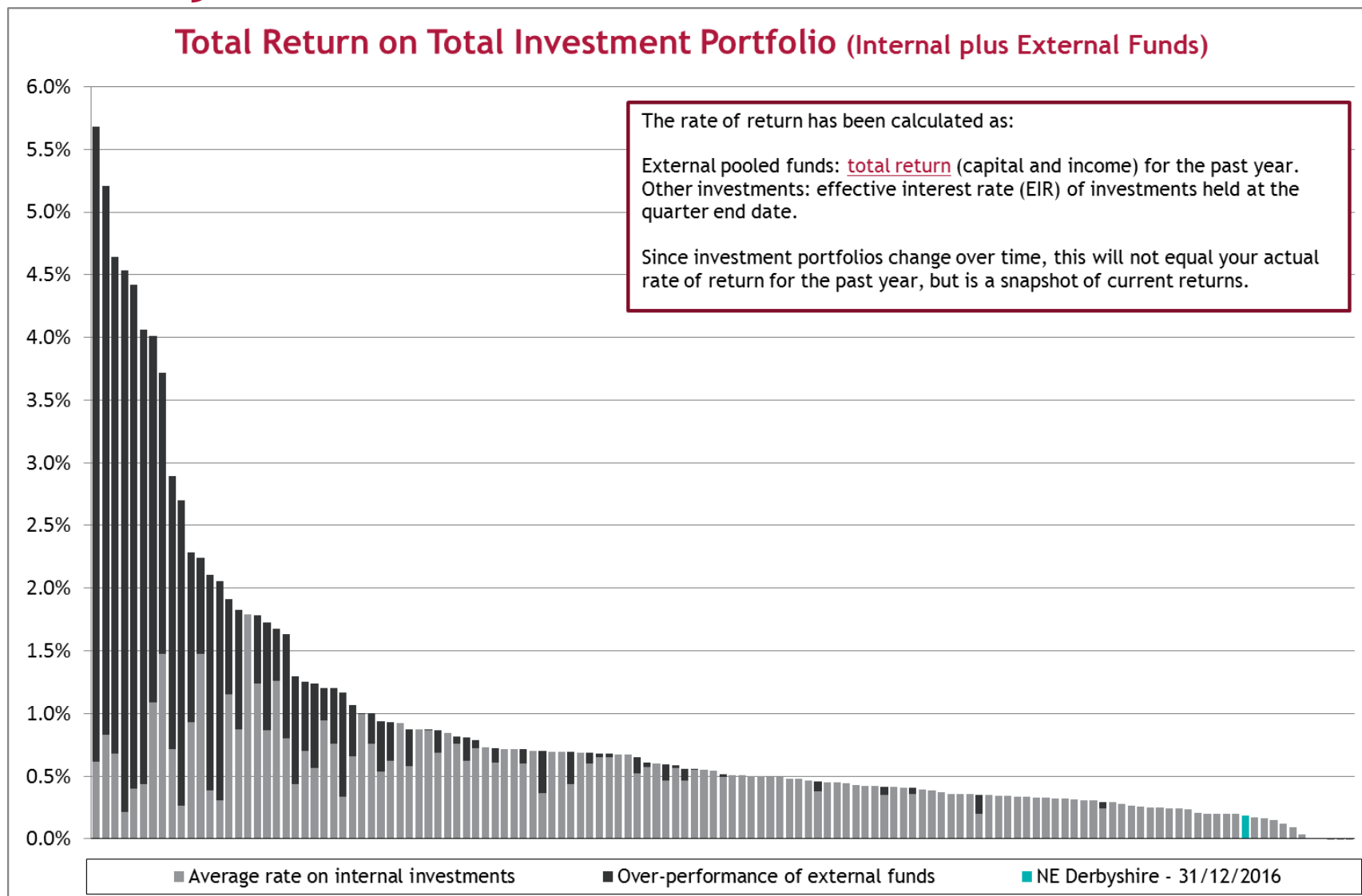


Short-term Borrowing

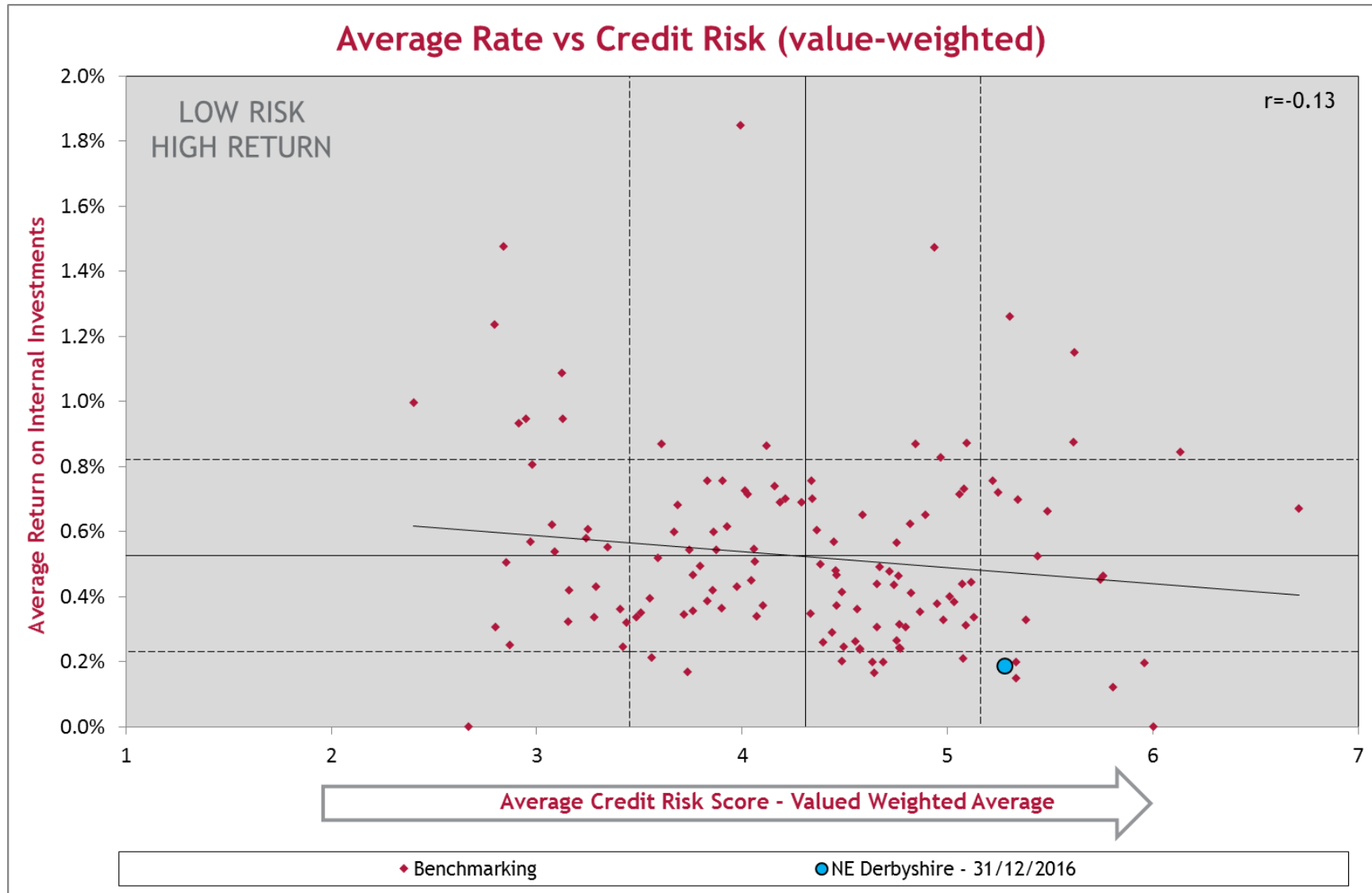
Loan Interest Rates



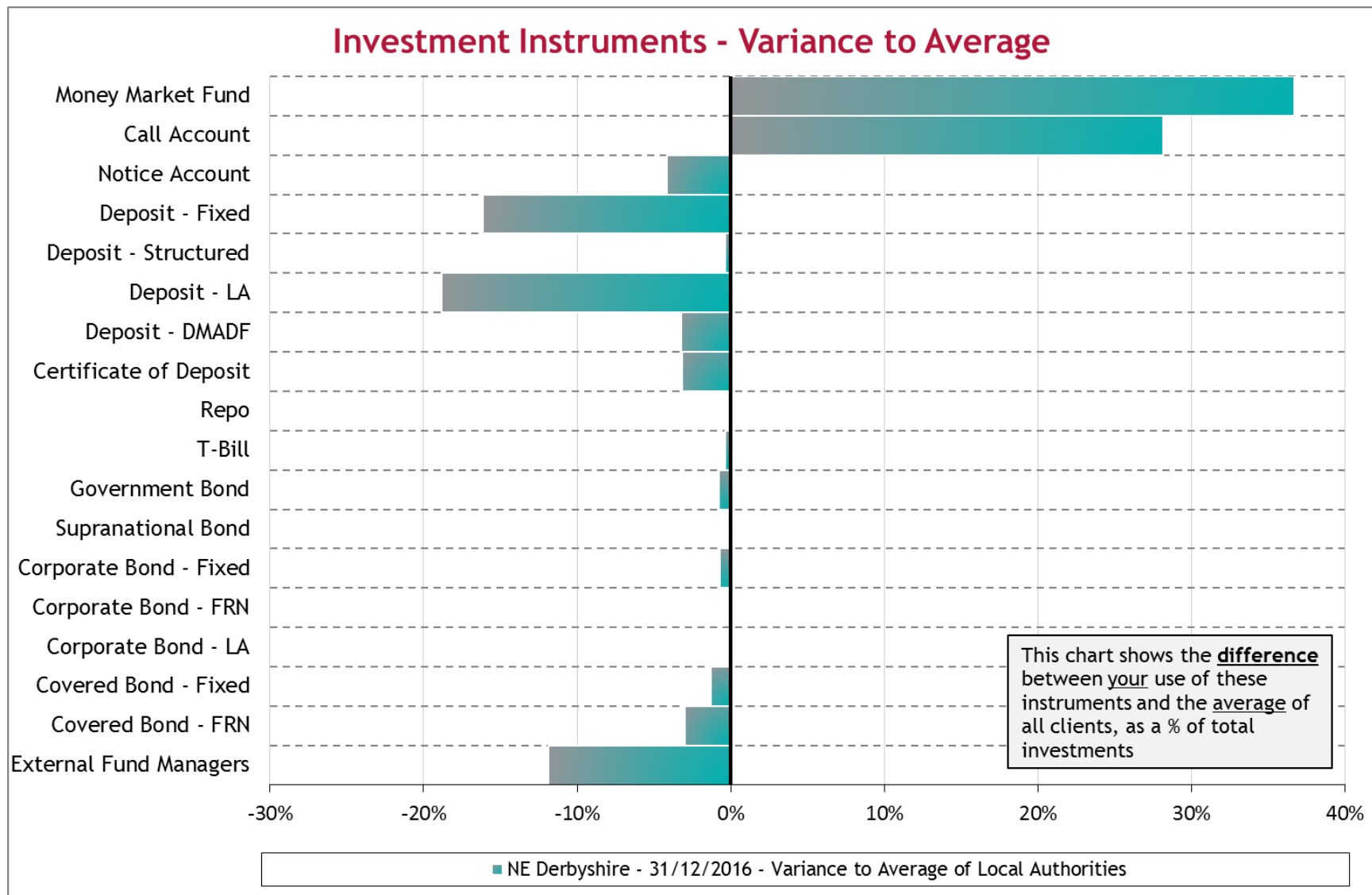
NE Derbyshire DC Investments - Total Return



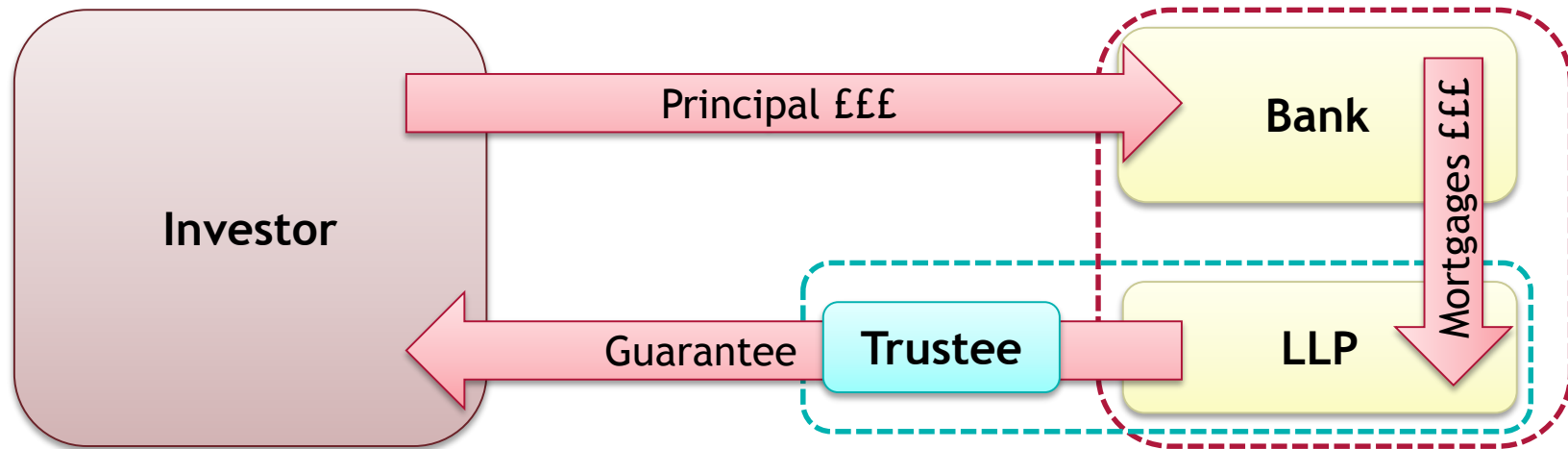
NE Derbyshire DC - Credit Risk/Return



NE Derbyshire DC - Financial Instruments



Covered Bonds



Covered bonds

- Issued by banks and building societies, and guaranteed by a group company that holds mortgage assets
- The trustee oversees the process, and acts in the investors' best interests
- This structure enables the investor to have effective security over the bank's mortgage assets

In the event of default

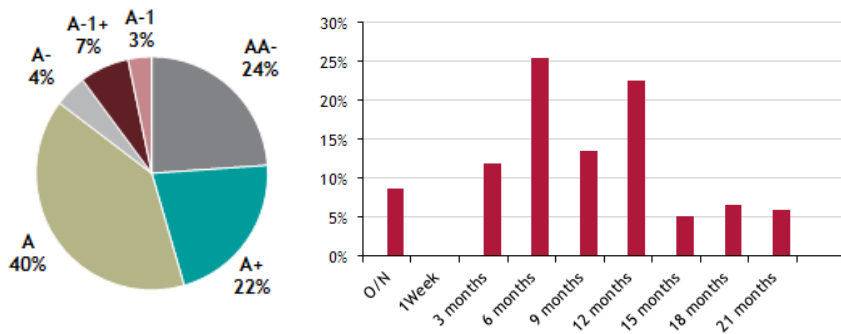
- If the bank enters insolvency, the investor has a claim over the bank's assets along with unsecured creditors
- The guarantor (which is a secured creditor of the bank) pays any shortfall on principal to the investor
- The trustee can order early redemption of bonds before insolvency if thought to be in investors' best interests
- Covered bonds are **exempt from bail-in**

Federated Prime Rate Cash Plus Fund

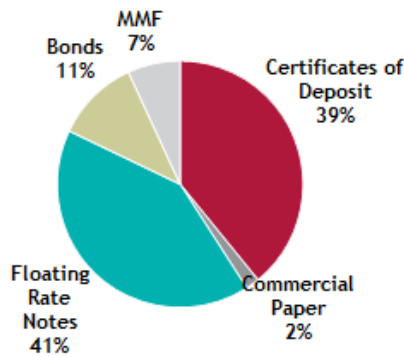
The fund aims to provide investors with stability of capital and income through investment in short term fixed and variable rate securities. The fund's weighted average maturity (WAM) is limited to 6 months and the maximum weighted average life (WAL) to 360 days. The fund is rated AAAF/S1+ by S&P

Fund size £742 m (Sep-16). A UCITS fund. Fees: Ongoing Charges for Fund (OCF) share class 2: 0.12% p.a.

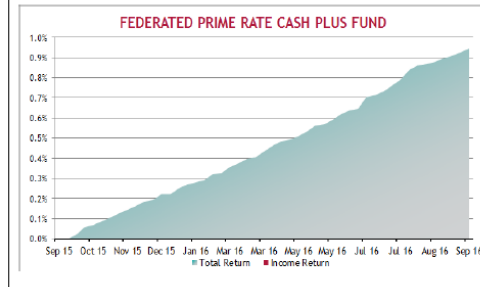
Credit and Maturity Profile 30/9/16



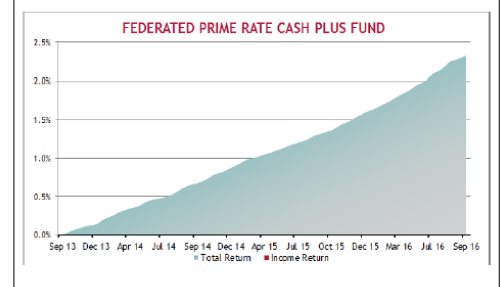
Asset Allocation 30/9/16



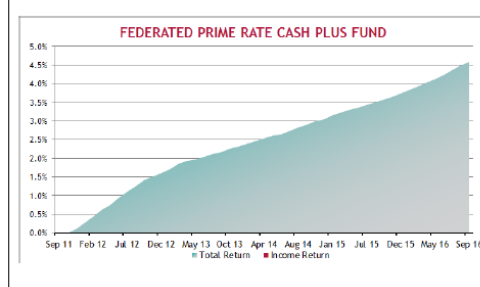
Total return 1 year to 30/9/2016



Cumulative Total return 3 years to 30/9/2016



Cumulative Total return 5 years to 30/9/2016



Performance Analysis to 30/9/2016

	Capital Return	Income Return	Total Return	Volatility
1 year	0.94%	--	0.94%	0.1%
3 years % p.a.	0.77%	--	0.77%	0.1%
5 years* % p.a.	0.92%	--	0.92%	0.1%

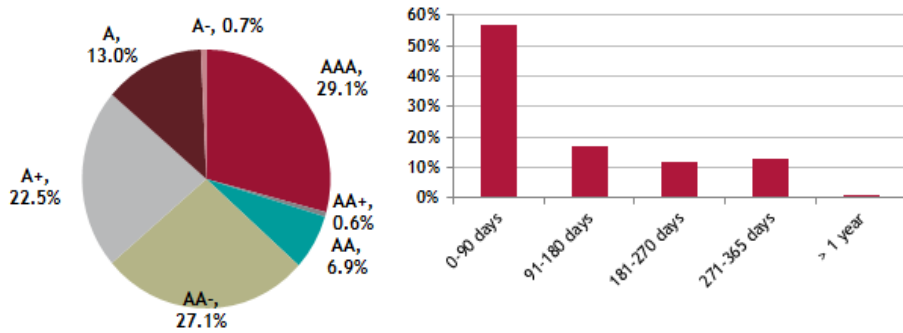
*period from Nov 2011

Royal London Cash Plus Fund

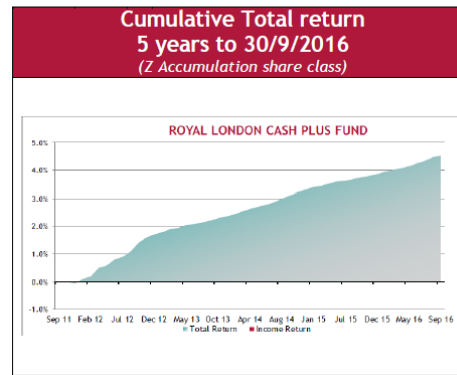
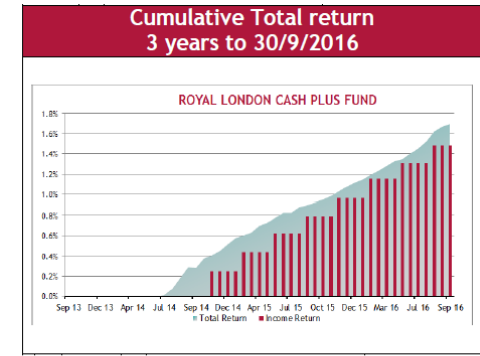
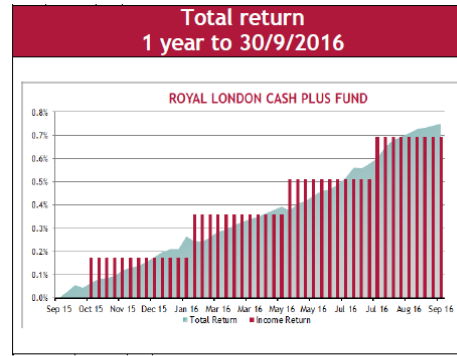
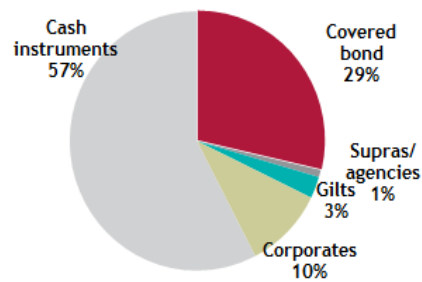
The fund aims to deliver capital growth and income over the medium term and aims to achieve +0.75% gross of fees above 7-day Libid over rolling 12-month periods. The fund's weighted average maturity (WAM) is limited to 1 year. The fund is rated AAA/V1 (Fitch)

Fund size £2.57 bn (Sep-16). A UCITS fund. Fees: Ongoing Charges for Fund (OCF) 0.16% p.a.

Credit and Maturity Profile 30/9/16



Asset Allocation 30/9/16



Performance Analysis to 30/9/2016

	Capital Return	Income Return	Total Return	Volatility
1 year*	0.06%	0.69%	0.75%	0.1%
3 years* % p.a.	0.09%	0.64%	0.73%	0.1%
5 years** % p.a.	0.89%	--	0.89%	0.2%

*Y Income Gross share class (1 year and from July 2014)
** Z Acc share class

Summary and Options

External Context

- US elections and monetary policy tightening and the UK vote to leave EU are expected to lead to slower economic growth and higher inflation
- Bank rate was cut to 0.25% in August 2016, and we forecast no change for the next 3 years
- Banks are now riskier homes for local authority deposits

Local Context

- At 31st January 2017 internal investments were yielding 0.19%, with the entire portfolio of £17.0m on a one day notice maturity.
- We would suggest that the portfolio is excessively liquid and the Council would benefit by considering longer term investments and pooled funds.
- The council should consider additional investment instruments which are not exposed to bail-in such as T-bills, covered bonds and lending to other LAs.

Advised Strategy

- Minimise investment risk - partly by minimising investment balances
- Then keep borrowing costs low with short-term loans from other local authorities

Thank you for Listening

All data has been sourced from Bloomberg and other publicly available information.

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