Room151

TREASURY INVESTMENT ROUNDTABLE

OCTOBER 4TH, 2017, LONDON

DIVERSIFIED INCOME, DUE DILIGENCE & INVESTMENT GOVERNANCE

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GOOD INVESTMENT

TO MARK THE LAUNCH OF CCLA'S DIVERSIFIED INCOME FUND, A MULTI-ASSET POOLED INVESTMENT VEHICLE, WE INVITED A GROUP OF COUNCIL TREASURERS TO DISCUSS THEIR APPETITE FOR DIFFERENT ASSET CLASSES, THE IMPORTANCE OF GOVERNANCE AND THE PERILS OF BEING LATE TO THE PARTY.

Room151

ROOM151 EVENTS & SPONSORED CONTENT

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AT THE TABLE

Paul Jones
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Forest of Dean DC and Cheltenham Borough Council

Jason Vaughan
Strategic Director & Chief Finance Officer
Dorset Councils Partnership

Danny Mather
Corporate Finance Manager
Warrington Borough Council

Sean Clark
Director of Finance and IT
Thurrock Council

Chris West
Consultant (moderator)

Charlotte Ryland
Director – Investments
CCLA

John Kelly
Client Director
CCLA

Peter Findlay
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Room151

TREASURY INVESTMENT ROUNDTABLE:
DIVERSIFIED INCOME DUE DILIGENCE & INVESTMENT GOVERNANCE

Chris West
I'm going to start by asking Charlotte just to talk very briefly about one of the multi-asset projects that CCLA has got just to stimulate a discussion.

Charlotte Ryland
Ok sure, so I'll talk a little bit about our thinking behind the launch of the DIF (Diversified Income Fund).

We've had a lot of conversations with local authorities whose treasurers have mainly focused on cash in the past. Clearly, in the current environment if you want to produce decent returns you have to look beyond just cash, and we know from conversations we've had, and from Room151 surveys, that treasurers are diversifying their assets and moving into other areas.

The question is, what other assets should you be looking at, how should you package those together and produce something which is sensible for you? The most obvious place to look is the bond market which is low volatility and seems a fairly safe place to be, but if you look at what you're getting in terms of gilt yields at the short end of the market, it's a pretty pathetic yield of around 42 basis points. You can move that out to, say, 30 years, take on an awful lot of duration and interest rate risk, and maybe get 1.9% which is still a pretty

Chris West, Consultant (moderator)

low return particularly in the context of inflation running at, say, 2.9%.

Then you have the corporate bond market where you take on credit risk, for an additional return but still not a real return. Next most obvious port of call is indeed property and a lot of local authorities moved into that successfully, either on their own behalf or, indeed, through pooled vehicles. I suppose our concern, just looking at property, is where we are in the cycle. Property has clearly done very well already, but do you want to lock yourself into one asset, particularly one which is very focused on the UK economy, so you're not getting any diversification of economic exposure?

We've also been looking at alternatives by which we mean things like infrastructure, whether that be social infrastructure, solar, wind farms, things like contractual income,

leasing projects and those we think have got pretty attractive returns. They're more complicated to manage than the bond market but we think quite interesting.

And then finally equities, which is maybe the one that's the most controversial, but what do they offer you? They offer you a decent capital return over the long term, assuming you are a long-term investor. If you have cash you can put away for just two or three years, clearly it's not appropriate, but if you're looking longer term then perhaps equities could fit the bill.

It also depends what kind of equity you buy. We are very much focused on quality companies, strong returns on capital, sustainable dividends and decent balance sheets: more the Unilever end of the market rather than the Glencore end.

We think there is scope to include equities within a broader stream of assets.

And then why use a pooled vehicle? Again, it's about that spread of assets you can get and the fact it is liquid so you can deal daily and get your money in and out if that is what you require.

Chris West
So, over to you colleagues. What alternative investment assets have you looked at and what do you feel about the muti-asset fund CCLA has developed?

Charlotte Ryland, CCLA

DIVERSIFICATION

Jason Vaughan
I suppose I've been sold already because two of my councils are in the DIF fund. I think it's about recognising the journey that councils are going on, from the traditional bank deposit stuff to looking at other things. There's less money coming into councils, interest rates are still very low, there's ongoing risk around the banks, and so we've been forced to look at different ways of preserving our money.

We've got a reasonable spread of assets, I guess, and have been moving away from traditional deposits for a period of time now. We've been in property for a few years and other multi-asset funds. Our mandate is to look at the income generation and obviously try and protect capital, but it's that diversification that we're looking for. It's a significant departure from what we would have done, traditionally, looking back five or six years.

Chris West
What sort of member involvement is there in making these decisions?

Jason Vaughan
We have a treasury management panel which covers all three councils and we have three sessions a year where we bring in our advisers to speak to them. Also, CCLA have presented to our members and are coming in January again, so we're trying to include members in the conversation and enhance their training through contact with our providers.

In terms of the day-to-day decision making, it's got to be delegated because of its nature. But the strategy is with us. We do an awful lot of reporting on treasury so we report to our scrutiny committee, to our audit committee and to our decision making committee, on a quarterly basis, of where our portfolio is.

Chris West
And they're quite comfortable with the multi-asset pool?

Sean Clark, Thurrock Council

"Our mandate is to look at the income generation and obviously try and protect capital, but it's that diversification that we're looking for"
Jason Vaughan

Jason Vaughan
Yes, absolutely, and that's because this isn't a quick thing we've just jumped into; it's a journey we've been on for a period of time. Some of them would be even more gung-ho, perhaps, than I would be on one or two things. I keep reminding them that it's a balance. Some of them wanted to put all of our funds into property a couple of years ago because it was doing so well and that isn't the game we're playing; we can't have all our eggs in one basket.

Chris West
Has it changed the relationship with your consultants or the way they're viewed?

Jason Vaughan
I'm not sure it has done greatly. Clearly we are looking for wider advice and you've got to be clear about who's making decisions. What we've learnt from previous experience is you need to understand who's advising you and who's making the decisions? We're very clear on where those governance issues sit. The members view our advisers as quite helpful, they provide the expertise that I can't carry as a 151 — that's why I pay them.

"I've cut services back as much as I can and have factored in traded income, such as waste collection, so you are then left having to find something which gives meaningful returns in the short term."
Sean Clark

Sean Clark
Listening to Jason, I think we're at a different stage of the journey. The treasury report goes through in February which sets the treasury management indicators and then, effectively, as long as I operate within those indicators, there's never been any secondary check, as such. That doesn't stop us having conversations with the portfolio holder of course; but in terms of an investment committee or anything like that, we've never done it.

That's just beginning to change now. We've just got papers going through where our administration wants six principles on a panel looking at investment decisions. It won't be just investments they look at and they won't look at every investment we make; we'll still have a fair bit of latitude. But any investment over £10m and over [a duration of] one year, for instance, needs to go through this panel.

Chris West
And what type of investments are you considering?

Sean Clark
So, we're just looking for opportunities where we can get a decent enough return to actually defend the budget. We have about the third lowest unitary budget in the country so, by definition, we've got about the third lowest cost per service; it never quite works that way but you know you're in that spectrum. We've got about £16m to find over the next three years and about £6m of that in the next year. I've cut services back as much as I can and have factored in traded income, such as waste collection, so you are then left having to find something which gives meaningful returns in the short term.

If you go directly into property, which is partly what we're looking at, you probably won't get any income for another three to four years because there's going to be a longish lead-in time. So, at the moment, we're doing quite a lot of investments with our cash and exploring others. Among those we've got solar, investments with CCLA, bio diversity investments and a bond which lends money to SMEs. As long as I can get comfort over the next three to five years then we can actually start concentrating on how to move that on.

Jason Vaughan
I think that's what's driving it. We're all having to make money somehow and, actually, treasury activity is one of the quickest things you can turn around, compared to say some other trading activity you can do. The other thing for me is, if it goes wrong, can I explain it to somebody? Does it seem reasonable? Do the people around me know what we're doing? Then, if it goes wrong, I want us all to be in it together because we understood what we were doing.

Chris West
So I want to bring in Paul.

Paul Jones, Forest of Dean DC and Cheltenham Borough Council

Paul Jones
The key message I'm getting from my members is about diversification and not being over-exposed to any one asset class. All of the areas we've captured, whether it be solar bonds, property funds, maritime, wind bonds, policy investments, it's all been about diversifying and not having our eggs in one basket. In Cheltenham's case, that is what happened with the Icelandic banks.

So, I think in terms of the CCLA multi asset fund, I'd probably be interested to put my toe in the water.

Looking at the wider dynamics of the latest government settlement—this idea of what is raised locally is spent locally and the drive towards business rates retention—that makes investments in our own communities much more interesting.

That can mean buying [real] assets that have already been built or, at the other end of the risk profile, it means developing [property] ourselves, which is currently happening in both of the districts that I look after.

I suppose taking those policy investments one stage further, we will look at investing in other assets that the council either has a direct interest in, like the airport, or some of the charities that are currently running our buildings. If they want to put in a major investment to a leisure centre or to a public rail asset, then there's a business case that generates the income and we will have all of those in our treasury management strategy. Primarily, they will probably be charged 3% plus base rate, something along those lines, so obviously it's win/win for both the organisation and the council.

ETHICAL

Chris West
Danny, focusing on treasury instruments, tell us about Warrington's journey.

Danny Mather
I think diversification for us probably began in earnest around four years ago with the CCLA property fund that we invested in. Since then we've become very active in the green energy field, so that's really been a policy decision for the council due to a number of reasons. The first is "returns" and, secondly, our members have been saying for years that they want to make our investments more ethical.

With our solar investments, for example, we're happy with the return we've been getting but also with the security as well. The work we've done with Sean (Sean Clark) and the London boroughs has seen us really go to town on the due diligence, working with the leading firms in the sector. I've got more confidence that our resources are safer there than the money we've got with RBS, for example, where it's not beyond comprehension that something could go wrong.

We've just invested £200m in a big business park in Warrington which we're treating as a treasury investment. Again, we've departed from the norm there and used an offshore tax structure held in Jersey. We've bought that asset to hold as a long-term treasury investment.

Danny Mather, Warrington Borough Council

Governance is critical to us, and we have a treasury management board that meets on a bi-monthly basis and anything new we take to members at the outset and they're involved in all the briefings. We involve members in risk management workshops as well.

We own 33% in a new challenger bank, called Redwood Bank, which we've done for two reasons. Firstly, we have a policy initiative to promote wider economic development and, secondly, we want to make a decent financial return for the authority.

We're looking at developing more collaborative investments, so some of the solar bonds we've done we're getting together with other local authorities to do as joint investments. The major advantages, of course, are sharing the due diligence costs, sharing the risk and drawing on a wider pool of risk management across a number of treasury teams, member committees and legal resources that the different councils bring to the table.

OPPORTUNITIES

Peter Findlay
Charlotte, can I ask you what you think about what you've heard so far about the potential risks these guys are taking on, looking at some of these opportunities individually compared to a pool fund?

Charlotte Ryland
One of the obvious ones is you're buying these things directly and therefore there's a liquidity issue, so if you wanted to get out, could you get out? Whereas with a pooled vehicle—yes, you could. If you're absolutely certain that's money you can lock away for ages, then that's absolutely fine.

Then I suppose the other issue is the due diligence you can do. Clearly Danny feels absolutely on top of it, but is every council in that position? Would every council do as much due diligence as clearly you guys have done, or is there a risk that they don't do their homework and someone ends up coming a cropper?

Jason Vaughan, Dorset Councils Partnership

Danny Mather
I probably share your concerns. I think there are authorities out there that perhaps don't have the expertise and it's easy to jump into stuff. There are different investment opportunities that cross my desk every day now and it would be so easy to invest. There is probably a scandal coming, but you know 400 authorities may do something well and if one gets it wrong it taints the sector.

John Kelly
It's probably the case that the ideas follow money and it's been well publicised that local authorities are investing in a broader range of assets now. Do you think there's a risk that attracts the slightly less scrupulous providers, offering ranges of returns which appear attractive but actually have levels of risk or uncertainty associated with them? That's my concern, that the skillset required to determine how much risk is associated with attractive returns varies across the country.

Chris West
I don't think the same opportunities are out there for every local authority. To use an analogy, this isn't like a sprint where you've got a field of people all very closely packed together and one might be slightly ahead of the others. It's much more like a marathon where the field is spread out over a very long distance and the front runners are lapping those at the back in terms of expertise, appetite for risk, experience and so on.

John Kelly
That's my point really. The pressure on those who have been slow to respond is probably even greater and at a time when the cycle has moved on, yields are lower and people offering products are new to the sector. You just wonder whether that combination leads to a level of risk that the early movers avoided.

Chris West
Any views on that?

" That's my concern, that the skillset required to determine how much risk is associated with attractive returns varies across the country."

John Kelly

Jason Vaughan
People are at different stages up and down the country and treasurers and section 151 officers have different starting points in terms of their budgets too. Some local authorities actually don't need to do a lot of this and, actually, they're financially OK. Although, there aren't many of those left now. The danger is somebody who's at the back of the pack now puts in a sprint to try and get to the front and if you're running the marathon the one thing you don't do is start sprinting half way through.

Danny Mather
It comes down to your strength of governance. If you've got good internal governance that you can channel any proposals through, then I think that does minimise the risk

I know councils are searching for yield because they need to bridge budget gaps, but also I think they are waking up to a new dawn and realising they have the powers to do this type of stuff.

The powers have been there since 2011 but the sector has been slow to realise the advantages. When I was trained you couldn't borrow to invest. I've done lots of presentations on this and I'm always asked 'can you borrow to invest?' And the fact of the matter is you can.

Peter Findlay
Is there much more long-term money identifiable within councils? Is there a good reason why councils are looking longer term with their investments, other than because they need to generate income somehow, or are they taking on too much liquidity risk?

Jason Vaughan
We've looked at our cash flows a lot harder than, perhaps, we ever have done before so that we can determine how much of our cash genuinely needs to be liquid. The reality is in the past we over-egged it. We had too much liquidity there and the money wasn't working hard enough for us. It's a lot smarter to refine those numbers and figure out how much money you really need in the short term.

Paul Jones
In Cheltenham's case the only real cash they've got is ear-marked reserves which are scheduled to be spent over the short to medium term. Forest of Dean, on the other hand, are still sitting on capital receipts from the sale of housing stock and I think it's been a learning curve for members that have realised over the last year that this sum of money is not doing much for us in cash deposits, which is really why we're looking more at diversification.

"It's much more like a marathon where the field is spread out over a very long distance and the front runners are lapping those at the back in terms of expertise, appetite for risk, experience and so on."
Chris West

Chris West
I really recognise Jason's point. Sometimes technical level officers within treasury departments in finance teams are really risk averse, or can be. We used to have this annual conversation about what was the cash flow forecast and I was always being told we we're going to run out of money in 18 months. And it just never happened. Now that is well-meaning colleagues just being cautious, imbued in a culture of prudence that perhaps has served us well for many years. But difficult times need new approaches and I think challenging that culture of risk aversion is an important development.

John Kelly
We've had a good run in the markets. Do you think councils are in this for the long run or because it's a sunny day? There will be a market correction at some point, how do you think councils will respond?

Danny Mather
I think it goes back to the due diligence again. Taking the property development we've just done, for example, we've modelled the project against stresses like the recession we saw in 2008. What would happen if the investment was impaired? What would happen to our revenue account? We've not just looked at the sunny picture but at the downside risks and we've made a rational long-term decision based on that.

Chris West
I can remember the day of the Icelandic banking crash, receiving a phone call very early in the morning from my chief executive in words that I wouldn't care to repeat in polite company, asking whether we had any money in Iceland and, if we did, she would want to have some very stern words with me. We didn't, but in a way it was kind of accidental because you could legitimately have had, based on every bit of advice that you'd got at the time.

John Kelly, CCLA

Paul Jones
I think that's why I've also got a treasury management panel and if nothing else it does enable you to take some collective responsibility. In answer to your original question Chris, would I be interested in looking at this particular multi-asset product, I personally would say yes, with some limited exposure; but what I would like to do is, obviously, take my members on that journey with me too. I think my members would say: we're not risk averse but want to be risk aware—so what are the risks of us moving into this?

Peter Findlay
Charlotte do you think what you've heard today bodes well for the Diversified Income Fund?

Charlotte Ryland
I think in the environment we're in with pressure on budgets and the point of view of returns available, clearly you have to have a wider remit and there are a lot of things that it sounds like you guys are doing yourselves, which is fantastic. But there is also, I would say, probably a role for something which is easily accessible, which has a big range of assets in there and is actively managed for you, along with all the other things that you're clearly doing.

Peter Findlay
And what's your view on the value of assets currently, given where we are in the cycle?

Charlotte Ryland
That is the difficult question that we wrestle with because it's hard to look at any asset class and say, this is desperately cheap. Almost all of them have been pushed up by quantitative easing and with the amount of cash flowing around
in the system.

We'd say that bonds are looking quite expensive and equities, relatively speaking are arguably better value. There's at least still earnings growth coming through in the equity market and, in terms of extended evaluation, the market is not as extended as it has been at certain points in the past. It always depends on what you're actually buying too; there's always scope for some things to grow better than others.

Property: we've been pulling back a little bit of our property exposure just because we think values have run a long way. You are still getting very decent rental income though, and what we would say is diversify your property exposure so that it's not just commercial property, but includes some of these specialist areas such as student accommodation.

"That is the difficult question that we wrestle with because it's hard to look at any asset class and say, this is desperately cheap. Almost all of them have been pushed up by quantitative easing…"
Charlotte Ryland

ABOUT THE SPONSOR

CCLA has managed local authority funds for over 40 years and charities for over 50 years.

The Diversified Income Fund is a balanced, multi-asset investment fund providing an attractive and rising income with the potential for increased capital values over time. Risk control is a key part of the investment approach: the fund is structured to provide a higher income than cash but with lower risk than property or longer dated bonds.

CCLA also manages **The Local Authorities' Property Fund and The Public Sector Deposit Fund**

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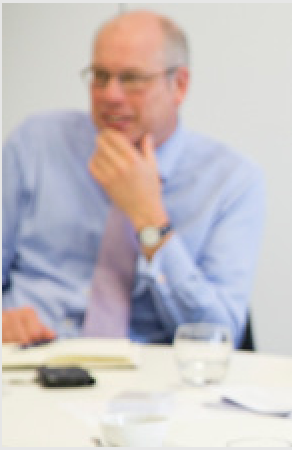

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