

COMMERCIAL BANKING

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# FINANCIAL FLEXIBILITY

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## Treasury Risk Management

- Interest rate risk
- Inflation risk
- Currency risk
- Commodity price risk
- Liquidity risk
- Funding risk
- Thematic reviews



# CORE FUNDING MODELS

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## Pre Crisis Funding Model

- 25y to 30y Libor loans from a UK bank
- 60% to 80% typically converted to fixed rates
- Fixed rates executed for various different tenors

## Post Crisis Funding Model

- 25y to 30y debt issued in the bond market to UK investors
- All cash flows fully fixed through to maturity
- Shorted dated RCFs provide liquidity and floating rate exposure

# CORE FUNDING MODELS

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## Similarities

- Long dated, committed, fixed rate debt
- Certainty on cost of funds
- Consents required for significant changes to the business

## Differences

- Less flexibility to have a mix a fixed / floating rate debt
- Less flexibility to tailor tenor of fixed rate maturities
- Bank credit margins historically flat. Credit curve now upward sloping.
- Bank relationship considers wider issues / relationship returns

# WHY LONG DATED FIXED RATE DEBT?

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## Benefits / rationale for long dated fixed rate funding

- To defer refinancing risk
- Match debt to long dated stable social rents
- Aligned with a 30 year business plan – forecasting and budgeting
- Long term certainty of interest costs to reduce risk
- Tradition – we've always funded this way
- Investors have appetite at this tenor – price tension increased



# WHAT ARE THE COST THOUGH?

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## Costs / drawbacks of long dated fixed rate funding

- High cost of carry when yield curve is upward sloping
- High cost of carry when credit curve is upward sloping
- Lack of flexibility to match individual revenue streams (commercial?)
- Concentration of refi risk (across the sector too)

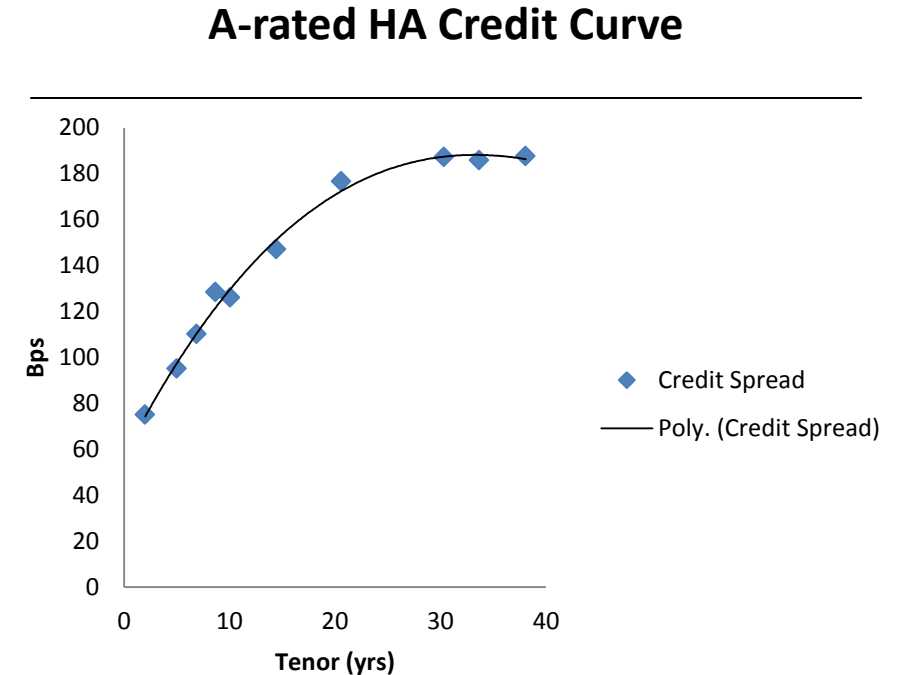
**Q: Are you paying a high cost of carry needlessly?**

# SOCIAL HOUSING CREDIT CURVE



Example of credit curve for an A-rated Housing Association

Years	Credit Spread	Source
2	75	Bank loan - LBG
5	95	Bank loan - LBG
6.86	110.1	bond mkt - bloomberg
8.68	128.4	bond mkt - bloomberg
10.07	126	bond mkt - bloomberg
14.44	147.1	bond mkt - bloomberg
20.59	176.6	bond mkt - bloomberg
30.34	187.2	bond mkt - bloomberg
33.68	185.8	bond mkt - bloomberg
38.07	187.6	bond mkt - bloomberg



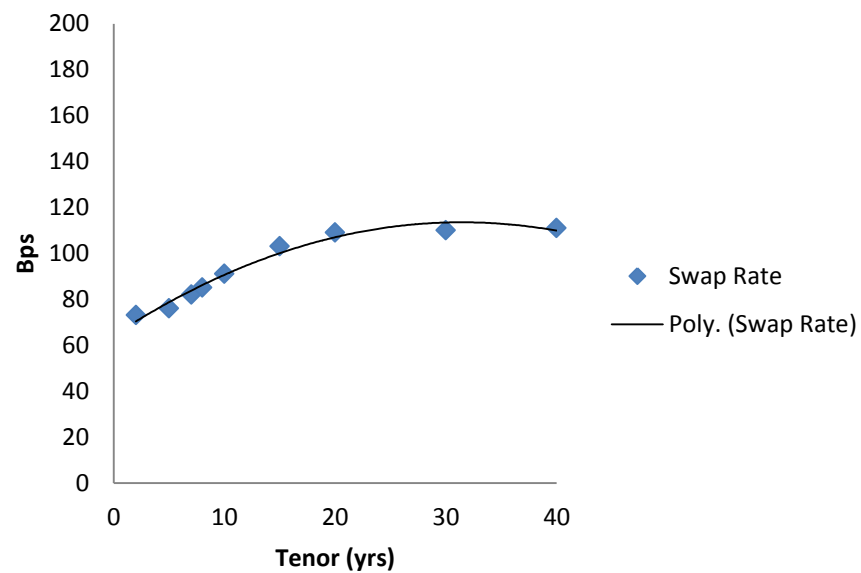


# STERLING SWAP CURVE

GBP swap rates

### Sterling Swap Curve

Years	Swap Rate	Source
2	73	Bloomberg
5	76	Bloomberg
7	82	Bloomberg
8	85	Bloomberg
10	91	Bloomberg
15	103	Bloomberg
20	109	Bloomberg
30	110	Bloomberg
40	111	Bloomberg





# FUNDING COSTS – 30 YEAR BOND

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What would it cost to fund for 30 years?

<b>Bond Market Funding – 30 years</b>	<b>As at 5<sup>th</sup> July 2019</b>
30yr Gilt Yield	<b>1.32%</b>
30yr Credit Spread	<b>1.87%</b>
New Issue Premium	<b>0.05%</b>
30y Fixed Cost of Funds	<b>3.24%</b>

# FUNDING COSTS – 10 YEAR BOND / 30 YEAR FIX



Is there a cheaper way to fund but still have 30yr certainty on rates?

Bond Market Funding – 10 years / 30yr swap	As at 5 <sup>th</sup> July 2019
10yr Gilt Yield	0.68%
10yr Credit Spread	1.26%
New Issue Premium	0.05%
10y Fixed Cost of Funds	1.99%
10y Swap to Floating	6mL + 1.09%
30y Swap to Fixed	1.10%
Swap Credit Spread	0.16%
Fixed Cost of Funds	2.35%

## PAUSE FOR THOUGHT ...

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### Where does this saving come from?

- 30yr bond: 3.24% vs 10yr bond + 30yr swap 2.35% = 0.89% saving
- Or £8.9m saving over 10yrs on £100m debt
- Credit spread
- Swap spread +0.16% vs – 0.22% = 0.38%

### What are the risks?

- Funding only locked in for 10yrs
- Credit spread could widen in 10yrs time.
- Swap MtM has accounting considerations (hedge accounting possible)

# FUNDING COSTS – 10 YEAR BANK LOAN / 30 YEAR FIX

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<b>Bank Loan – 10 years / 30yr Swap</b>	<b>As at 5<sup>th</sup> July 2019</b>
30yr Swap Rate	<b>1.10%</b>
Swap Credit Spread	<b>0.18%</b>
10yr Debt Credit Spread	<b>1.26%</b>
Fixed Cost of Funds	<b>2.54%</b>

# FUNDING COSTS – 30 YEAR BOND / 10 YEAR FIX



What if we fund long but hedge short?

Bond market funding – 30 years / 10yr swap	As at 5 <sup>th</sup> July 2019
30yr Gilt Yield	1.32%
30yr Credit Spread	1.87%
New Issue Premium	0.05%
30yr Fixed Cost of Funds	3.24%
30yr Swap to Floating	6mL + 2.15%
10yr Swap to Fixed	0.84%
Swap Credit Spread	0.54%
10yr Fixed Cost of Funds	3.53%

# COMPARISONS

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<b>Funding / Hedging</b>	<b>Cost of Funds</b>
30yr Bond / 30yr Fix	<b>3.24%</b>
10yr Bond / 30yr Fix	<b>2.35%</b>
10yr Loan / 30yr Fix	<b>2.54%</b>
30yr Bond / 10yr Fix	<b>3.53%</b>
10yr Bond / 10yr Fix	<b>1.99%</b>

# SUMMARY

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- Focusing on very long dated bond issuance sacrifices flexibility
- Also incurs a significant cost of carry at present
- Currently, carry costs are mostly from an upward sloping credit curve
- Yield curve is unusually flat
- Swap spreads inverted at the long end
- Long dated fixed rate debt still possible without paying the 30y credit spread.
- Taking a flexible approach allows the business to match cash flows better & can save costs

**Q:- When you come to issue debt, what will you do?**



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