Local Government Association

**LGA Executive**
12 January 2012

**Item 4**

# Local Authority Bonds

**Purpose of report**

For Decision.

**Summary**

In March 2011 the LGA Executive established a Task and Finish Group. The aim was to determine whether the local authority sector could establish a collective agency that could raise funds efficiently and on-lend them at lower cost than the PWLB. This paper reports on the work done by the Task and Finish and proposes that plans for a collective agency should be further developed.

**Recommendation**

1. To authorise the Task and Finish Group to publish the outline business case for the development of a collective agency, on behalf of the LGA.
2. To extend the remit of the Task and Finish Group to oversee work on the pre-implementation stage of the project, reporting back in 6 months' time. This work will include undertaking detailed testing of this proposal with Local Authorities (including seeking their commitment to financial support for implementation), Government and other agencies and the finance sector; and the commissioning of preparatory work in order to put an implementation team in place.
3. To authorise the LGA to contribute up to a further £150,000 in the 2011-12 financial year to support this preparatory work with any further contributions in 2012-13 considered as part of that year's budget review.

**Action**

Director of Finance and Resources

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# Local Authority Bonds

## Background

1. On 20 October 2010 the Government announced that the Public Works Loans Board's (PWLB) interest rates for loans to local authorities would be increased from 0.2% to 1% above the gilts market rates. This significantly increased the interest cost on loans borrowed by local authorities.

2. Whilst some larger authorities may now find it cost effective to raise their own bonds as an alternative to borrowing from the PWLB, this option is not likely to be cost effective for most authorities, because bond issues are typically over £150 million in size; and the absence of an alternative source of lending leaves local authorities vulnerable to further changes in the PWLB's terms of trade.

3. In March 2011 the LG Executive therefore established a Task and Finish Group. The aim was to determine whether the local authority sector could establish a collective agency that could raise funds efficiently and on-lend them at lower cost than the PWLB.

## Approach and conclusions of the Task and Finish Group

4. The Task and Finish Group approached its work by testing whether a viable business case for an alternative to the PWLB arrangements existed. The outline business case has been completed, informed by advice from HSBC, city legal firm Clifford Chance LLP and professional services firm Ernst and Young.

5. Three main approaches were considered of which the preferred option is for an agency that:

   5.1 Is owned by the sector and sufficiently capitalised to ensure an AAA/Aaa credit rating (and thus ensure the lowest possible cost of funds).

   5.2 Raises funds from capital markets at regular intervals and on-lends them to participating authorities.

6. Such an agency should also help create a liquid market for local authority bonds. This should benefit those councils that decide they want to issue their own bonds.

**Benefits and costs of a collective agency**

7. After accounting for its own running costs such an agency should, in stable bond market conditions, be able to raise funds in the bond market at around 0.5% above the long-term gilt rate and on-lend to participating authorities at an interest rate of between 0.7% to 0.8% above the gilt yield.

8. This would mean an individual authority borrowing £100 million for 20 years would secure £4.7 million of savings in interest payments (undiscounted) over the life of the loan compared to the current PWLB rate.

9. To establish the agency would cost approximately £2.5 million and would take around two years.

10. It is estimated the agency would cost between £2 million to £4 million a year to operate, depending on the complexity of its operations.

11. In the longer-term the agency would need to secure a 25% market share of local authority borrowing in order to be competitive.

12. The agency is expected to have a AAA/Aaa credit rating. The proposed agency does not rely on cross-guarantees (which are not likely to be legal at present) but is underpinned by the strong credit of its local authority borrowers and supported by additional credit support in the form of a debt service liquidity facility and subordinated debt.

13. An LGA survey in September 2011 of 60 Finance Directors who were asked about the concept of a collective agency in an outline paper found 97% “in principle” support for a collective agency.

**Recommendation, next steps and financial implications**

14. Taking into account the likely benefits of a collective borrowing agency, the Task and Finish Group considers that further work should now be done to develop the proposal. This will involve some significant costs in commissioning preparatory work, and further testing of the extent of local authority and other support, including in particular whether local authorities are prepared to make an initial financial commitment to the agency. The Task and Finish Group therefore seeks the Executive’s approval to carry out this further work over the next 6 months and report back. A budget of a further £150,000 for the current financial year is sought (which can be funded from underspends elsewhere). As part of the testing of the proposal, the Task and Finish Group requests authority to publish the Outline Business Case.

15. The Task and Finish Group’s detailed report is appended. The Outline Business Case is being sent to members of the Executive confidentially, under separate cover.

# Local Authority Bonds - Detailed report

## Background

1. On 20 October 2010 the Government announced that PWLB rates would be increased to 1% above the corresponding gilt rate.

2. As a result in March 2011 the LGA Executive established a Task and Finish Group chaired by Cllr Edward Lord OBE JP. The group includes representatives of the four political parties and a representative from the Welsh LGA. The Convention of Scottish Local Authorities (COSLA) has been kept informed of developments. Officers from the LGA and Local Partnerships provide support to the group.

3. The aim of the Task and Finish Group was to determine whether the sector could establish a collective agency that could raise funds efficiently and on-lend them to participating authorities at lower cost than the PWLB.

4. The group concluded that to deliver robust conclusions:

   4.1. Independent, specialist, professional advice would be needed; and

   4.2. The outline business case should be structured following the Treasury "Five Case" model.

5. The LGA established a budget for independent advice. A competitive procurement followed and resulted in HSBC/Ernst and Young being appointed as banking and financial advisor and Clifford Chance LLP being appointed as legal advisor.

6. The public sector accountancy body (CIPFA) established a technical group to support this work, and act as a professional sounding board. That group included leading local government capital and treasury practitioners.

7. Officers have discussed emerging thinking with a range of banks and other institutions across government as the work has developed.

## Context - Importance of infrastructure spending

8. Infrastructure spending supports this country's long-term economic growth. Capital spending is also part of the way local authorities achieve efficiency savings. The LGA analysed the benefits of capital spending in its report: "Funding and planning for Infrastructure" (2010) and concluded that capital

spending creates substantial local economic benefits. The main conclusions of that report were:

8.1. Every £1 spent on construction leads to an increase in UK GDP of £2.84;

8.2. Every £1 spent generates a 56 pence return to the exchequer though tax revenue and benefit savings; and

8.3. Each £1 million allocated to road maintenance creates or safeguards ten to fifteen jobs and adds £500,000 to the local supply chain.

9. Capital spending on infrastructure is often financed by borrowing. That can only proceed if the borrowing is prudent and affordable. Taking steps to reduce the cost of borrowing is therefore in the interests of councils and the local economies they support.

**Context - Strong locally led governance over borrowing**

10. Local authority capital spending is regulated through a combination of statute and rules set by the finance profession. Long-term borrowing is only permitted for capital purposes.

11. The law relating to capital finance in England and Wales flows from the Local Government Act 2003. This act established a system where local authorities must take a long term view about how much money they can afford to borrow. The Local Government Act 2003 is supplemented by statutory instruments issued by Department for Communities and Local Government and guidance documents issued by CIPFA.

12. Capital spending is overseen by each local authority's Chief Financial Officer. HM Treasury retains powers to intervene if it judges that a local authority is acting imprudently or if national economic conditions warrant a reduction in total borrowing.

13. Nothing in the outline business case seeks to change these arrangements. The proposals in this report do not facilitate any additional borrowing over what is already permitted within the capital regulatory system. The aim is simply to deliver borrowing at lower costs to local authorities and generate savings for local authorities and, therefore, for council tax payers.

14. The existing arrangements with the HM Treasury retaining ultimate regulatory control over borrowing are to be maintained.

15. The aim is for local authorities to have access to diverse sources of funding. The PWLB should remain as a highly flexible source of funding, and it will be

important that the proposed collective agency works closely with the Debt Management Office to ensure both agencies secure the best rates for their borrowing.

16. Local authorities with larger borrowing requirements may elect to issue their own bonds and local authorities can still access finance via banks - particularly for shorter-term financing needs. It should be noted however that the collective agency will be capable of servicing both large and short-term funding requests and may provide cost savings when compared to individual local authority issues (due in part to lower overall transaction costs and larger issuance sizes).

**Work undertaken**

17. The work to develop the outline business case comprised:

    17.1. A review of collective arrangements operating and under development in other countries.

    17.2. Informal discussions with a range of UK and other agencies with experience of this area.

    17.3. A consultation exercise to determine the level of local authority interest in a possible collective arrangement.

    17.4. An evaluation of potential options, leading to a shortlist of three main options, which were subject to an in-depth review by external advisors.

    17.5. A review of the legislation and the powers of local authorities to develop a collective agency.

    17.6. Financial modelling of the costs of operating a collective arrangement.

    17.7. A review of the likely credit rating of the collective agency.

    17.8. An outline structure of the proposed agency and a high level description of governance arrangements.

18. Having completed this work our advisors have been able to estimate the indicative all in cost of borrowing though this collective agency.

**Option appraisal**

19. The potential collective arrangement was considered against a series of “critical success factors”. These comprised:

19.1. That the likely cost of borrowing (including the running costs of a collective agency) should be significantly less than is currently available.

19.2. That the arrangement should either be legally deliverable, or the route for securing powers should be reasonably clear.

19.3. That the arrangement should be accessible to large and small local authorities.

19.4. That funding should be (so far as is possible) predictable and no more susceptible to adverse impact from external factors than the PWLB.

19.5. That the agency should be capable of being established within a reasonable time and cost.

20. Other wider factors were considered when looking at options. Local authorities should find it straightforward to access funds when they need them and all governance arrangements should be transparent.

21. Finally it was noted that the arrangements should encourage local authorities to adopt best practice in their financial management. It was assumed from the outset that the collective agency would not receive an explicit government guarantee.

**Options considered**

22. Three main options were considered in detail:

22.1. A collective agency, regularly raising money from bond markets and on-lending to participating authorities on demand from them. The agency would be rated based in part on cross-guarantees from participating authorities.

22.2. A collective agency operating in the same way as the first option except that instead of relying upon cross-guarantees the agency would obtain credit support in the form of risk capital from participating authorities or third party investors.

22.3. A simpler joint agency that would coordinate bond issuance by participating authorities.

23. A final reference option, of doing nothing, was kept under review.

A cross-guarantee model

24. The first option - of a collective agency gaining its strength from a system of cross-guarantees - is similar to the one that already operates in Finland. The benefit of this approach is that the agency operates without an explicit government guarantee. The agency gains a AAA/Aaa rating from the combined financial strength represented by cross-guarantees of participating authorities.

25. However the legal position of English and Welsh local authorities does not support this approach. Our legal advisors (Clifford Chance) have reviewed this area and conclude:

    25.1. The general power of competence, though widely drawn, is not specific on the question of the provision of cross-guarantees and therefore may be subject to interpretation in the courts.

    25.2. Existing case law regarding local authority guarantees of loans, where such guarantees were held to be ultra vires, may make it difficult for investors to be comfortable with the legal risks associated with a finance structure which relies on local authorities cross-guaranteeing their respective financial obligations.

26. Clifford Chance advise that the clearest method of providing local authorities with the power to grant cross-guarantees would be by way of primary legislation. Such legislation could also set out the powers and responsibilities of the collective agency. This is the approach recently adopted in New Zealand.

27. Securing such legislation would require support in Parliament, which would add to the uncertainty about delivery and significantly extend the time taken to establish the agency.

28. HSBC advises that if such an agency were to be established, in normal market conditions and assuming a AAA/Aaa ratings outcome, it may be able to raise funds in the bond market around 0.5% above the long-term gilt rate and on-lend them at around 0.7% to 0.8% above the gilt rate.

A credit enhanced model without cross-guarantees

29. This second option is similar to the Finnish example in operation, but instead of relying on cross-guarantees would require participating authorities or other third parties to provide risk capital to the collective agency. This risk capital would provide the credit enhancement to bonds issued by the collective agency by absorbing any losses caused by individual participating authorities failing to meet their obligations in respect of funds lent by the collective agency.

30. Clifford Chance advises that this arrangement appears to be within the existing powers of local authorities. Equity investments or other risk capital would be treated as capital expenditure by the local authorities. Local authorities would therefore need appropriate internal approvals in order to invest funds in such risk capital.

31. Surpluses generated by the spread between the cost of the debt raised by the collective agency and the debt service received from participating authorities would allow a return on the risk capital provided by participating authorities.

32. Appropriately capitalised and subject to various non-financial parameters (such as clarity around how the agency interacts with/sits alongside the PWLB), such an agency may also secure a AAA/Aaa rating. As such, in normal market conditions it may be able to raise funds in the bond market around 0.5% above the long-term gilt rate and on-lend them at around 0.7% to 0.8% above the gilt rate.

33. If there were wider support within the sector, it is considered that such an agency could be established within two years.

<u>A “pass through issuer “model</u>

34. A third option was considered. This would be an agency similar in operation to The Housing Finance Corporation (THFC). The agency would bring together local authorities that were seeking somewhat smaller sums and package their requirements into a larger, single bond offering.

35. The agency would act in response to demand, and so would not have a regular presence on the bond market. The agency would not necessarily be rated, but the bonds issued would be rated. The rating would depend on the credit rating of the authorities participating in each issuance.

36. The agency could probably operate at a lower cost to the agencies contemplated in the first two models. The drawbacks are that borrowing costs are likely to be higher because the agency would:

    36.1. Be raising bonds at irregular periods and would therefore not build up a regular presence in the bond markets;

    36.2. Lack substantial capitalisation or cross-guarantees; and

    36.3. Be issuing bonds of varying credit quality - depending on the underlying ratings of the local authorities participating in each issue.

37. Local authorities seeking funds could have to wait for weeks or months as assembling bond offerings would take time.

38. Such an arrangement could be established within existing local authorities' powers, but it is likely the agency would usually only be able to raise and on-lend funds at above the current PWLB rate - though there could be times when it could deliver specific bonds at below this rate.

39. This collective agency could be established within two years.

Do nothing

40. The final option is to not develop a collective agency at this time.

41. Local authorities would still have different main options for accessing capital. They could borrow from the PWLB at 1.0% above the long-term gilt rate. This remains an attractive interest rate - albeit not as attractive as the one offered in the past. The PWLB is currently a flexible option that currently provides funds at short notice and in comparatively small amounts. This option would still allow local authorities to develop a collective agency if PWLB rates were to increase in the future, or it's lending arrangements were to significantly change.

42. Local authorities seeking over £150 million to £200 million could issue their own bonds. However, this would not be an “on demand” option, as a debut bond issue by a local authority (even where that authority has already secured a credit rating) would take some weeks/months to execute.

43. The price of those bonds would vary, in part depending on the credit rating of the local authority and how well the market for bonds develops. The cost of debt of those bonds is particularly difficult to assess, as it will depend on a wide range of factors, including the credit rating of the local authority and the view of the bond market of the individual local authority.

44. This individual approach relies on the local authorities that are issuing bonds to manage the process effectively, as the reputation of the sector (and price of bonds) relies on how the bond purchasers view the bond issuers.

Conclusion from option appraisal

45. The option of a collective agency without cross-guarantees, but securing a AAA/Aaa rating based on an enhanced capitalisation, most closely matches the critical success factors.

## Consultation with local government

46. Over late summer 2011 the LGA circulated a consultation paper on this subject. This was sent to all Finance Directors in England together with a series of questions about the proposed arrangements. Copies of the survey were sent to

associations in Wales and Scotland who consulted with their member authorities.

47. 60 responses were received[1]. 97% of those responding were supportive of the principle of a collective arrangement, whilst 75% would in principle consider participating in a collective arrangement. Most of those reporting support but not proposing to join explained they did not envisage they would have borrowing needs in the foreseeable future.

**How the proposed agency would operate**

48. A key issue will be for the collective agency to secure a AAA/Aaa credit rating, because this affects reduces the price of bonds. There are three credit rating agencies and it is proposed the agency would be rated by at least two of them.

49. The agency would have a small team of staff and their salaries would be set by reference to public sector salary norms. The agency, as a public sector classified company, would have its staff remuneration made public.

50. The body would be overseen by a board of directors. This board would include members from:

    50.1. Local government - with majority representation as the owners of the agency.

    50.2. Independent members, in particular those with credit or risk management backgrounds.

51. Collective agencies in other countries have various forms of government blessing or support. The next stage of work will explore this issue in more detail.

52. The intention is that the agency will be a stable and credible counterparty for prospective bond investors. The governance of the agency will reflect the intended culture that is:

    52.1. Straightforward. The use of complex or opaque financial instruments will be avoided.

    52.2. Transparent. The activities of the agency will be open, the agency will follow modern public sector principles and publish comprehensive management information.

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[1] WLGA coordinated the consultation on behalf of their members.

52.3. Collective. The agency will balance the voices of smaller and larger authorities, much as in the way the LGA does at present. Views of other stakeholders will also be considered.

52.4. Efficient. The agency will emphasise value for money, as income is drawn from public funds. Profits will be used to provide returns on the risk capital invested, and otherwise will be retained in the organisation to build its capital base.

**Structure and operating costs of the agency**

53. Ernst and Young have modelled the costs and financing requirements of the collective agency. The main agency costs are:

53.1. The running costs. The key elements will be the treasury and credit assessment functions, as rating agencies look closely at these activities. Depending on how the agency is structured, and the level of demand from participating authorities, the total running cost should be between £2 million and £4 million a year.

53.2. The level of capitalisation required.

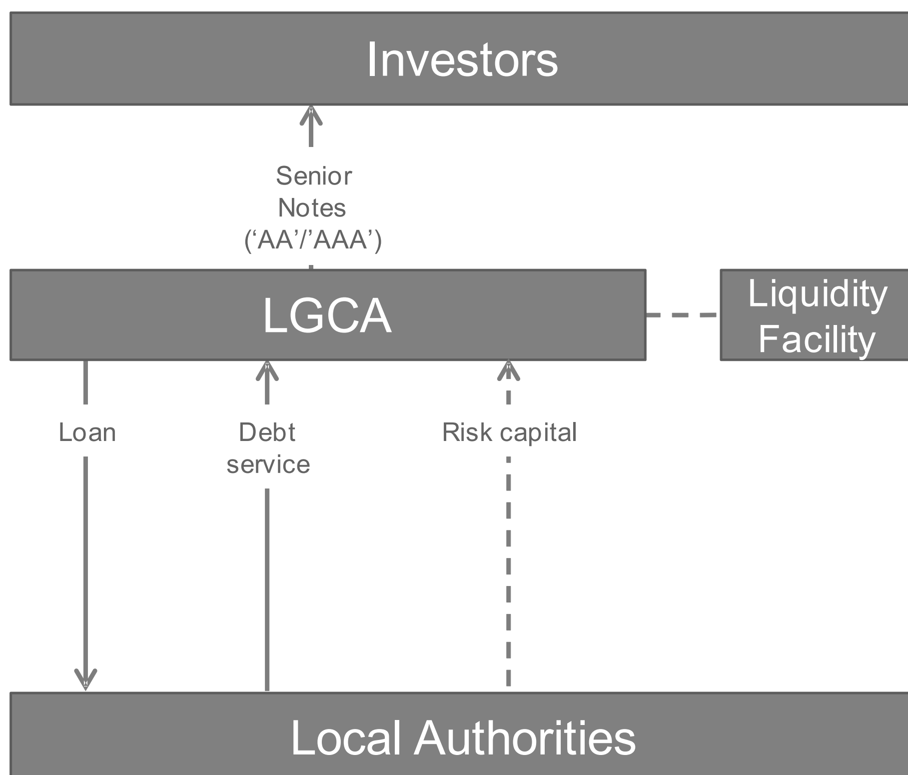
54. The issuing entity will be a public limited company. Participating authorities will invest risk capital in the company. Any surpluses generated by the company will be retained within the organisation to:

54.1. Increase its capitalisation and (by increasing its financial strength) reduce borrowing costs to participating authorities.

54.2. Pay a return on the risk capital.

54.3. Allow the return of the risk capital over time.

55. This arrangement could mean that, subject to prevailing bond market conditions at the time of issue, participating authorities may be able to borrow funds at between 0.7% and 0.8% above the current gilt rates.




56. The base case scenario of the agency financial model is based on a 40 year business plan.

57. Based on the aforementioned rates, an individual authority borrowing £100 million for 20 years would secure £4.7 million of savings in interest payments (undiscounted) over the life of the loan compared to the current PWLB rate.

58. The illustration below shows the various categories of agency cost which form a year on year loan charge ("Implied annual loan charge for members"), based on a 25 year business plan.

59. The financial model is based on prudent assumptions of local authority future capital spending and local authority borrowing levels. It is assumed the collective agency works in a competitive market, with a share of 20% rising to 50% in 2024.

**Factors that deliver a AAA/Aaa rating**

60. Important elements in securing a AAA/Aaa credit rating are the stance of the HM Treasury and Debt Management Office as to the remit of the agency, strong governance systems and appropriate capitalisation within the wider system of prudential borrowing and government oversight. The main requirements include:

60.1. A diverse base of participating authorities.

60.2. A wide ownership structure.

60.3. Strong and clear internal processes, particularly in respect of treasury management and credit assessment.

60.4. Independent oversight by a board of independent directors comprising representatives from participating authorities and wider stakeholders.

60.5. Clear rules that provide clarity on the limits of the agency operations.

60.6. Transparent and simple funding arrangements.

60.7. Access to diverse sources of wholesale funding.

60.8. An adequate level of capitalisation.

60.9. An adequately sized debt service reserve account.

**Borrowing funds from the collective agency**

61. The agency will aim to build a presence in the bond markets. In the medium-term the agency would look to develop a programme of regular issues.

62. The agency will aim to minimise the amount of funding it holds before on lending. This will require liaison between participating authorities and the agency as to when those funds are required. In the early years of operation a "matched funding" approach may be adopted, minimising the risk of the agency holding significant unneeded funds.

63. The collective agency will operate under the assumption that the participating authorities are operating an effective prudential code system. However as the collective agency represents all participating authorities and its financial standing is based on their collective reputation, loan funding could not be assumed to be "on demand".

64. The issues the collective agency may consider in making lending decisions are expected to be similar to those of a commercial lender, regulatory or oversight body. For the purposes of assessing whether the financial model is viable it has been assumed that every council will borrow at the same rate of interest. Options about lending policies would form part of the detailed consultation with authorities.

65. Participating authorities will be under a duty to provide their collective agency with details of their financial standing, including but not limited to their audited

accounts, and to inform the agency if material changes arise during their financial year. The collective agency through its credit committee will review this information and liaise with participating authorities.

66. The credit committee of the collective agency would normally meet individual local authorities that represented an unusual credit position before making a final decision about lending funds. This might include local authorities with qualified accounts, critical external financial governance assessments or unusually high levels of borrowing.

67. A local authority wishing to borrow funds will have given a clear indication about their proposed borrowing. The collective agency will have reviewed those proposals and would have given pre-approval. The expectation is that the participating authorities will borrow at the time and in the amounts they previously indicated at the start of the year.

**Wider benefits beyond the sector**

68. This business case focuses on the benefits for participating authorities, but our discussions have identified wider benefits from this collective approach:

    68.1. It should provide a viable alternative and complementary funding source to the PWLB.

    68.2. A new class of highly rated and prudently managed bonds will be created. In an uncertain financial environment these could prove attractive for pension funds and other investors who can invest in UK infrastructure.

    68.3. By reducing expenses paid for separate bond issues.

    68.4. A collective agency owned in part at least by and lending to its participating authorities creates a different set of incentives over and above the rules within the prudential code:

    68.5. A membership based collective agency becomes a key part of the sector led approach. Participating authorities are well placed to identify if an individual participating authority’s borrowing appears excessive, and can intervene early on behalf of the sector.

    68.6. The collective agency acts as the face of local government. The agency could have an educational role, and will provide the financial sector (including rating agencies) with comprehensive information about local authority finances - widening the corporate understanding of this sector.

68.7. The collective agency will work with the professional regulators and parts of central government. It will bring additional perspectives into discussions about best practice in capital spending and prudential indicators.

**Retail bonds**

69. One of the issues highlighted by councillors has been how a collective approach could facilitate individuals to buy local authority bonds. The potential is that such bonds provide citizens to have a sense of ownership and interest in investment in infrastructure.

70. The possibility of accessing the retail bond market has been considered. Developments regarding the retail bond market recently introduced by the London Stock Exchange will be monitored during the next stages in the process

**Risks**

71. The option appraisal has looked at the major risks that could affect this project and the operation of the collective agency. The key risks are set out below. A fuller set of risks are contained within the business case document.

| **Risk + Impact** | **What can be done to mitigate it** |
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| Changes in government policy (eg a reduction in future PWLB interest rates) make the collective agency business model unviable. | Liaison with government throughout the planning and consultation period can reduce this risk.<br><br>Close working and potential Treasury involvement in operation of the collective agency will allow the agency to be aware of and react to national government concerns.<br><br>It should also be noted that a do-nothing approach leaves local authorities at risk if a subsequent government were to decide to further increase the PWLB interest rate or change its terms of trade.<br><br>However it should be recognised that even after mitigating actions this remains a significant risk to the success of the project. |
| Lack of interest by local government sector means the agency does not achieve market share. | The business model has been built on prudent assumptions.<br><br>In spite of offering significantly lower borrowing costs it has been assumed only 20% of local authority borrowing will be raised through this mechanism in the initial stage, rising to 50% by 2024. |

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| | A key in reducing this risk is in the extent and quality of sector consultation prior to launch.<br><br>Close liaison with elected Members, Finance Directors and Treasury Advisors will be needed to mitigate this risk. |
| Slow take-up means the collective agency does not cover its operating costs in initial years, or borrows money that it is then unable to lend. | As above, but in addition it is proposed that local authorities would have to give a commitment at the start of the year setting out when and how much they anticipate borrowing. |
| Significant loss of confidence in the UK local authority sector makes it harder for the collective agency to access funds at competitive rates. | The collective agency must put a high priority on explaining the workings and inherent quality of UK local government to bond purchasers.<br><br>It should be noted that local government is already potentially exposed to this risk as funds raised from the PWLB are indirectly raised from bonds markets. |
| Emergence of alternative models for local authority borrowing | It will be important to test the proposed collective approach with other market providers as part of the extended consultation process.<br><br>The international examples provide some assurance that these collective agencies, once established, become fixed parts of the borrowing landscape in their countries. |
| Low levels of capital spending or low levels of borrowing over an extended period. | The business model is based on assumptions drawn from:<br><br>• The comprehensive spending review, and that total capital spending falls year on year to 2013 and then stays below 2012 levels throughout the CSR forecast years.<br><br>• An estimate of the percentage of total capital spending financed by borrowing.<br><br>• A prudent assumption of market share by the collective agency. |
| Major failure by local authority leads to reduction in confidence by bond purchasers and higher prices paid for local authority bonds. | This risk affects not just a collective agency, but also a model where local authorities raise individual bonds.<br><br>The existing prudential code arrangements, and backstop powers for Treasury already provide substantial assurance |

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| | to bond purchasers.<br><br>The proposed collective approach provides an additional incentive for local authorities to continue to operate prudently.<br><br>The agency credit assessment function will also review local authorities and their financial standing. |
| Predicted credit spreads prove to be over optimistic and are not achieved once agency is established. | Stress testing of financial model over the six month period to June 2012 with key assumptions checked with a wide range of stakeholders. |
| Loss of UK AAA/Aaa rating results in consequential downgrade of the collective agency (and all other UK local authority bonds) | The six-month period pre-implementation phase allows the sector to assess if this is a realistic possibility.<br><br>A reduction in credit rating would of course affect the price of all borrowing - including that made through the PWLB. |

**Conclusion**

72. Higher PWLB interest rates and a potential lack of competition means:

    72.1. All local authorities are paying more for their borrowing than we believe may be possible via a collective approach.

    72.2. Smaller local authorities are disadvantaged because they can’t easily access capital markets.

    72.3. The sector as a whole is vulnerable to further changes to PWLB rates.

73. Local authority led collective agencies have operated in a number of countries, in some cases for over a century. In other countries local authorities are establishing such agencies with the support of their national governments.

74. An England and Wales local authority run agency offers the possibility of delivering cheaper borrowing by ensuring local authorities utilise their collective credit strength.

75. Such an agency has the potential to be an important part of the sector-led improvement agenda - by strengthening the already strong governance of this area.

76. The Local Government Collective Agency (LGCA) is a solution developed by the sector for the sector, and its success or failure rests principally in the sector’s appetite for adoption and support of such an alternative funding route.