Local Government Association

LGA Executive
12 September 2013

Item 7

Municipal Bonds Agency

Purpose of report

For information and discussion.

Summary

This report provides an update on the proposal to establish a Local Government Collective Agency to issue municipal bonds and dispense loans to councils for capital projects.

Recommendation

That the Executive note the report.

Action

Officers to be cognizant of members' comments as the project progresses.

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Background

1. One of the ten big ideas in *Rewiring Public Services* is '*Boost investment in infrastructure by recreating the thriving market in municipal bonds which England once had and most other countries still have'.* Reviving council borrowing directly through the capital markets offers the prospect of cheaper borrowing and a better deal for the council tax payer. It would also free us from Treasury control by ensuring there was an alternative source of funding to the Public Works Loans Board (PWLB), and through that route, keep PWLB rates low too. Council bonds would offer investors a direct route to invest in capital projects in a way that government bonds do not (three-quarters of the Treasury's borrowing goes to fund revenue spending). A revived municipal bond market would be a powerful expression of our confidence as a sector, and our commitment to investing in economic growth.

2. Since the completion of the outline business case for the establishment of a Municipal Bonds Agency in January 2012, the Treasury has introduced a 0.2 per cent discount on the standard rate on loans from the PWLB, which currently means a rate of 0.8 per cent above the gilt rate. This is known as the certainty rate. However, it is only available to those authorities providing improved transparency on their locally determined long-term borrowing and associated capital spending plans and updating it annually. Although this reduces the cost of borrowing to registered councils, it still leaves them vulnerable to further changes in the PWLB terms of trade; ties them to regular updates to DCLG/Debt Management Office (DMO) on their capital spending plans; and does little to give them the necessary certainty to make effective long term funding decisions.

3. In addition to the certainty rate, the Government has introduced a project rate, which will give English councils working with their Local Enterprise Partnership (LEP) access to cheaper borrowing. The project rate is 0.4 per cent below the standard rate (i.e. a premium of 0.6 per cent on the gilt rate) will be available from 1 November 2013 and is being made available to support strategic local capital investment projects. The total value of loans at the reduced rate will be £1.5 billion across England with each LEP receiving its own allocation. These allocations do not constrain access to borrowing at the standard or certainty rates.

4. The outline business case assessed that a municipal bonds agency should, in stable bond market conditions, be able to raise funds in the bond market at around 0.5 per cent above the long-term gilt rate and on-lend to participating authorities at an interest rate of 0.7 per cent to 0.8 per cent above the gilt rate (i.e. competing or undercutting the PWLB).

The aim

5. The aim of this paper is to update the Executive on progress with taking forward plans to establish a Local Government Collective Agency that can raise funds from capital markets at regular intervals and on-lend them to participating authorities.

Recent activity

6. The LGA's Task and Finish Group on Municipal Bonds asked officers earlier this year to develop plans to move from the outline business case into an implementation phase.

7. The Chairman has also exchanged correspondence with the Chief Secretary to the Treasury and met him on 1 May. While it is apparent that the Treasury is less than keen on the prospect of local government setting up a Bonds Agency, the Chief Secretary has made it clear that '*it remains for the local authority sector to determine collectively whether a local authority bonds agency could be delivered on sustainable and affordable footing*'. Following his meeting with the Chief Secretary, the Chairman undertook to keep him updated as our work gathers pace and has made him aware of our plans to move the proposal forward.

8. At a Conference fringe event, following his opening speech, in which he launched our rewiring proposals, the Chairman formally set out where the LGA now stands on the question of a local government bonds agency and announced that the LGA feels ready to start laying the practical foundations on which a collective bonds agency could be built.

9. He has written to the leaders of a number of councils, which had previously expressed support for the idea, asking them, to make contact with the LGA for an initial discussion about what getting in on the ground floor of this project will involve. This has been followed up by an e-mail to Leaders of all councils asking for expressions of interest. A similar letter has been sent by the Chief Executive to the Chief Executives and Chief Financial Officers of the same councils written to by the Chairman.

Next steps

10. There are four key phases between now and a collective bonds agency being able to start operations. In order to put the sector in a position to set up such an agency within the calendar year 2014, certain key assumptions have to be made:

    10.1 The Agency will be established very broadly along the lines set out in the 2012 LGA/Local Partnerships outline business case.

    10.2 The Agency will be led to set-up by a shadow agency structure populated by credible experts who are unlikely, in general, to be drawn from the LGA's own staff.

    10.3 The project will need to be funded between a budget commitment from the LGA and commitments from councils.

10.4 The project needs to be developed in partnership with the councils which will ultimately use (and on the existing business case, own quasi-equity in) the agency.

10.5 The agency will proceed only if the business case continues to be credible in the eyes of potential lenders.

11. **Phase 1. Commitment and budget setting** (underway, complete by end October) – To enable further action this phase will:

11.1 Seek evidence for council commitment to the project among a core of credible potential members of the agency.

11.2 Draw up a budget envelope for the project up based on the existing business case and on the scale of potential contributions from councils.

11.3 Confirm that funding is available. This will depend on the ability of the LGA to make budgetary provision and the willingness of core of councils to make a financial contribution. [Assumptions 10.3 and 10.4]

12. A decision on whether or not to proceed will have to be made in the autumn and will depend on the level of firm commitment from interested councils.

13. **Phase 2. Pre-shadow enabling** (autumn 2013) - In order to set up shadow agency structures to lead the set-up project [assumption 10.2]; a prior project phase will be needed to develop role descriptions and run a recruitment to the shadow structures. This will require a limited review of the business case to ensure, among other things, that the tasks to which people are being recruited are sufficiently clear and credible to attract the right people and direct them clearly after their recruitment [Assumptions 10.1 and 10.5].

14. **Phase 3. Shadow Agency** (2014) – The tasks of the shadow agency will be to:

13.1 Develop a detailed project plan.

13.2 Fully refresh the business plan and operating model.

13.3 Establish the necessary organisational, legal and financial structures in line with that refresh.

13.4 Develop relationships with financial market players and peers and with DCLG, the Treasury and more specifically the DMO.

15. As its work nears completion, a permanent board and executive staff will need to be recruited and accommodated.

16. **Phase 4. Launch** (by end of 2014) - The permanent agency board and staff take responsibility for its operations in line with the agreed project timetable.

Project Governance

17. At the end of phase 1 the Leadership Board on the recommendation of the Task and Finish Group will decide whether to proceed to Phase 2.

18. Phase 2 will be overseen by a steering group bringing together councils committed to working with the project and chaired by an elected member. The steering group will advise the LGA on the overall direction of the project, and on budgetary matters, including decisions on retaining external advisers for the duration of this phase.

19. In Phase 3, the shadow agency will be given a mandate and budget by the steering group and will be required to submit a project plan for the steering group's approval and to report progress at intervals set by the steering group.

20. By Phase 4 the agency will be a free standing entity, governed by a board that includes representatives of local government.

Conclusion

21. This is a complex and demanding project, with a number of risks, key of which are a lack of council support both undermining the credibility of the project and leading to insufficient funding; the government undermining the project through excessive scepticism and manipulation of the PWLB interest rates; and the business case being seen as outdated or not credible. But the benefits of having Local Government Collective Agency are judged to outweigh the risks. It offers councils a potentially cheaper source of capital funding and importantly frees them from the uncertainty of unpredictable government adjustment of PWLB interest rates and the significantly higher repayment burden any increase would imply. Effort to mitigate the risks will focus on working closely with interested councils, the Government and the Treasury, to give them a sound understanding of what we are trying to do.

Financial Implications

22. The Outline Business Case estimated an Agency would cost approximately £2.7million to establish. The elements of this which need to be spent in advance of launch will need to be funded by a mix of contributions from the LGA's own budget and advance payments by councils which would be members of the agency; those advance payments will be converted after launch into subordinated debt securities of the agency. The Outline Business Case anticipates that these risk capital subscriptions for establishment costs will be remunerated at commercial rates of return.