Local Government Association

Resources Board

17 October 2014

Appendix A: Municipal Bonds Agency Update

Establishing a UK Municipal Bonds Agency

Introduction

1. 75 per cent of council long-term borrowing sits with the Public Works Loans Board (PWLB). This near monopoly over local authority lending leaves councils vulnerable to non-market driven changes in the rates at which they can borrow and can hamper long term capital planning. The raising of interest rates, to one per cent above the gilt rate, at the end of 2010 was one example of such a change and it led to the LGA publishing a business case for a Municipal Bonds Agency at the beginning of 2012.

2. Work to establish the Agency as the Local Capital Finance Company (LCFC) finally got under way in 2014, based on a revised and updated business case. A two page summary of the business case can be accessed on the LGA web site at this link.

Purpose

3. The Agency's single purpose is to reduce councils' capital costs over the long term. It will do this by:

    a. Raising money on the capital markets through issuing bonds
    b. Arranging lending or borrowing directly between local authorities
    c. Sourcing funding from other third party sources such as banks, pension funds and insurance companies.

How will it do this?

4. It aims to be able to lend to eligible councils at a lower rate than the PWLB or than if the councils were to issue their own bonds. This lower rate will be attained by:

    a. Achieving an AAA/sovereign-like credit rating through a joint and several guarantee and holding adequate risk capital of three to five per cent of the total volume of bonds.
    b. Issuing bonds in benchmark sizes of £250 million to £300 million.
    c. Sourcing capital at low interest rates from third parties

Other considerations

5. There are other important factors for councils to consider beyond price:

a. Reducing exposure to shifting government lending policies through increased competition and diversity of lending sources.
b. Creation of a potential new mechanism for prudent investment by pension funds in local government infrastructure.
c. Increased transparency and borrowing: while the PWLB processes are very quick, they don't carry the normal level of scrutiny lending large sums of money would entail. Experience in other countries has shown that an Agency's credit processes aligned with the incentive of lower borrowing costs, and the oversight of peers, has strengthened the overall credit worthiness of councils.
d. The creation of a centre of expertise at the intersection between capital markets and local government finance.
e. Tailored flexibility evolving from the development of the centre of expertise.

6. It should be noted that the proposals are grounded in the prudential code and the revised business case reinforces the principle that borrowing by councils must be prudent and affordable. In developing the revised business case, meetings were held with six of the top ten leading sterling syndicate banks, with whom links are being maintained and the consensus remains that there is likely to be significant demand for the Agency's bonds.

Investment in the Agency

7. The Agency doesn't just offer the prospect of cheaper borrowing for councils, but also an investment opportunity for both councils and council pension funds. The latter not only have the option of purchasing the bonds, but like councils they can invest in the establishment of the Agency and take an equity stake in it. While the revised business case presents a strong financial argument, without first securing the investment required to establish the Agency, and, second, finding committed borrowers for the capital raised from the first bond, it won't be possible to proceed.

8. Currently 38 councils have joined the LGA to invest just over £4.5 million in the Agency. They are of all types and sizes; from all sides of the political spectrum; and from all over the country. After a successful first phase, we are well on the way to meeting our target of £8 million - £10 million. We aim to achieve this during phase 2 of the equity raise, which is now underway.

9. There is still time and opportunity for councils to invest in the Agency and we would be very keen to hear from councils wishing to become either equity investors or borrowers from the Agency. Points of contact are:

a. the SRO Paul Raynes (paul.raynes@local.gov.uk tel. 0207 664 3037)
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Establishment of the Company

10. Because of the clear sector support for the Agency, the LCFC was set up initially as a platform for the equity raising process. It is the incorporated legal entity underpinning the UK Municipal Bonds Agency. A small team of interims with significant experience of both the capital markets and local government between them has been recruited to:

    a. Prepare the company for launch
    b. Develop the processes and procedures needed to take the first bond to market in March/April next year and on-lend the capital raised to councils.

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