

*PART A

Report to: Cabinet
Date of meeting: 23 July 2014
Report of: Joanne Wagstaffe
Title: Municipal Bonds Agency

1.0 **SUMMARY**

- 1.1 The Local Government Association (LGA) is developing a proposal to establish a Municipal Bonds Agency (the Agency). The benefits of doing this will be that local authorities should have access to cheaper rates of borrowing than they may otherwise be the case.
- 1.2 The LGA are looking for authorities who may wish to investing in the Agency. This report sets out a proposal for Watford Borough Council in response to the LGA Agency business case.

2.0 **RECOMMENDATIONS**

- 2.1 Cabinet agrees to support the Local Government Association in developing a Municipal Bonds Agency.
- 2.2 Cabinet agrees to invest £20,000 into the Agency subject to approval of the final terms and conditions.

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3.0 **DETAILED PROPOSAL**

- 3.1 The LGA has been developing a proposal to establish a Municipal Bonds Agency. This is in response to its view that the Public Works Loan Board (PWLB) borrowing rates have become expensive and relatively inflexible as a source of funding for local authorities. A list of Q&A provided by the LGA on the Agency can be found at Appendix 1.
- 3.2 The PWLB is currently the source of the majority of local authority borrowing. The Agency is designed to offer councils access to a cheaper rate of borrowing than those currently available from the PWLB.
- 3.3 The agency would borrow in bulk from the bond market and lend in smaller amounts to authorities of all sizes. This should enable authorities to access more competitive rates than they would otherwise be able to. The Agency may also arrange for lending or borrowing directly from local authorities. In addition it may also source funding from other third parties, such as banks, pension funds or insurance companies.
- 3.4 The LGA is looking to local authorities for investment to set up the Agency, which in turn will help other local authorities with their financial situation if they are in a borrowing position, through being able to offer cheaper borrowing rates.
- 3.6 There are a number of risks attached to setting up the Agency. The risks to the Agency are contained in the Revised Business Case Summary (Appendix 2) and in summary are:
- inability to raise the operating capital;
 - demand for borrowing;
 - market pricing;
 - PWLB rates;
 - Attracting the right people.
- 3.7 There are also risks to the Council in that it may not recover its initial investment in the Agency. Full risks will be known once the full details of the Agency are released. A review of the Revised Business Case has been undertaken by the Council's Treasury Management Advisers and this can be seen at Appendix 3.
- 3.8 The Agency is currently considering a joint and several guarantee from the borrowers. The joint and several guarantee would enable any amount which is in default to be distributed amongst those providing the guarantee. The guarantee will be provided by the local authorities borrowing from the Agency.
- 3.9 A joint and several guarantee would enable the Agency to borrow from the capital markets at a lower rate than it could otherwise. It will also enable the shares to be listed on the London Stock Exchange. This may result in a saving in borrowing costs of £7.2M over the life of a 30 year £100M loan. There are clearly risks attached to a joint and several guarantee but these may be mitigated by:
- Security over borrowing and the High Court process

- Proportionality/right of recourse
 - The risk capital
 - Statutory and budgetary controls in Councils
 - The prudential code and the Minimum Revenue Provision
 - The statutory responsibilities of Finance Directors (section 151 officers).
 - Government Reserve Powers
- 3.10 Risk capital will be the required to provide protection against borrower default. This will be raised from the borrowers through holding back 3-5%. This will provide risk capital of 3-5% of the total loans provided. In reality this will mean that borrowers will have to borrow more than they require in order to provide the required risk capital.
- 3.11 The structure of the Agency has not been finalised but is expected to be a private sector company which will be owned by local government. It will have a Board of Directors which will have appropriate finance and capital markets experience. The Board will also include three members elected by the shareholders. It will have shares which will be transferable and therefore can be sold to other local authorities or other eligible public bodies.
- 3.12 Once the Agency has become established and a profit is being generated then dividends will be paid to shareholders. This will allow investors to start recouping their investments. Initial investors are expected to have more favourable terms than those which join at a later date.
- 3.13 Guidance from the LGA suggests that smaller authorities may wish to consider investing 10,000 - £50,000 in the Agency. It is therefore proposed that Watford Borough Council supports the Agency with a £20,000 investment.
- 3.14 The LGA is asking interested parties to issue a letter of intent, in advance of formal committee agreement, so as to gauge interest in the Agency. They would like this letter to be received by 12:00 noon on the 17th July 2014.

4.0 **IMPLICATIONS**

Implications are listed below.

4.1 **Financial**

- 4.1.1 It is proposed that a financial investment of £20,000 is made into the Agency subject to approval of the final terms. The investment prospectus has not yet been issued, but the investment is likely to be in the form of ordinary shares. The investment is likely to be in two stages, with the second stage dependent on further review of the project. The initial phase or mobilisation phased is estimated to require £400,000 and this will therefore limit the potential loss that any investors will incur.
- 4.1.2 The Council does not currently anticipate having to move into a borrowing position, over the life of the Medium Term financial Strategy, however, if this changes then one of the anticipated benefits of the Agency is lower borrowing rates which would be beneficial to the Council in the long term.

- 4.1.3 It should be noted that this is a start-up proposal and there is a real risk that some or all the equity investment might be lost if the Agency fails to succeed.
- 4.1.4 The Shared Director of Finance comments that the investment can be funded from the Economic Impact Reserve.
- 4.2 **Legal Issues** (Monitoring Officer)
 - 4.2.1 The Head of Democracy and Governance comments that the Council has a general power of competence under the Localism Act 2011 that provides sufficient vires to enable it to take part in a company such as this. The documentation from the LGA refers to having had counsels opinion on the proposal but this has not been shared . The LGA have already set up a limited company and should cabinet choose to invest then the council would become a shareholder. The risks have been set out in the report. It is also not clear what level of further investment would be sought from initial shareholders in stage 2.
- 4.3 **Equalities**
 - 4.3.1 NA
- 4.4 **Potential Risks**
 - 4.4.1 These are contained in the report.
- 4.5 **Staffing**
 - 4.5.1 NA
- 4.6 **Accommodation**
 - 4.6.1 NA
- 4.7 **Community Safety**
 - 4.7.1 NA
- 4.8 **Sustainability**
 - 4.8.1 NA

Appendices

- Appendix 1 – Municipal Bonds Agency Q&A from the LGA
- Appendix 2 – Revised Business Case Summary from the LGA
- Appendix 3 – Review of the Municipal Bonds Agency – Revised Business Case Summary from Capita

Background Papers

- Establishment of a Local Government Collective Agency for the issue of Local Authority Bonds. A report to the Executive Board of the LGA March 2014.
<http://www.local.gov.uk/documents/10180/11531/MBA+Report+Final.pdf/037bbcf0-e7f5-4f06-946e-98e7e824ce49>