

Municipal Bonds Agency Q & A

What will the Agency be?

It will be an independent company owned by local government with the sole aim of reducing financing costs for councils through arranging lending at competitive interest rates. It is envisaged that the company will fund lending through any or all of the following:

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

What is the purpose of the Agency?

It will offer councils a viable alternative source of capital funding at a lower cost than existing sources and introduce sector owned diversity into the local government lending market. It will allow local authorities greater control over their funding costs in the future, by being able to demonstrate the value of peer pressure and capital market disciplines

Who would own it?

It will be owned solely by the local authorities or their pension funds that invest in its establishment. They will become shareholders in the Agency and therefore have a say in the way it is run. In due course, we would expect to be able to accommodate all local authorities, who wish to become shareholders.

Who would run it?

The Agency expects to have a wide local authority shareholder base. It will be a limited company, with its own Board of Directors comprising local authority finance experts, financial services experts from risk management and debt capital markets backgrounds and representatives elected by shareholders, all of who will go through a rigorous selection process.

How will councils recoup their investments?

It is envisaged that once the Agency is generating sufficient profit, it would be able to start paying a dividend to investors, while delivering economic benefits to borrowers. Its aim, as reflected in its incorporation documents, will be to deliver an overall benefit to the local government sector as a whole, and any future dividend policy set by its board would be subject to that. Its shares will be transferrable and therefore a council could sell its shares to other local authorities or eligible public bodies.

Does it have Ministerial support?

The Government's view is that it is within the powers of local authorities to establish a municipal bond agency. Ministers have said, "It remains for the local authority sector to determine collectively whether a local authority bond agency could be delivered on

a sustainable and affordable footing. It is consistent with the localism agenda that the autonomous local government sector considers whether it is able to deliver and sustain alternative financing models.”

What happens if the Public Works Loans Board changes its interest rates?

The effect of PWLB rate change on the Bonds Agency’s business would depend on its amount and how permanent the change was. The business case assesses the risk from future PWLB competition. Nevertheless the Treasury has said publicly that reducing PWLB margins is not being considered.

How long will it take to establish the Agency?

The business case assumes that the Agency would be ready to issue its first bonds in March/April 2015 to meet the normal peaks in council demand for borrowing.

Is additional legislation required to enable the Agency to be established?

No. Councils have the necessary powers.

What impact will this proposal have on the Government’s control of overall government borrowing?

Nothing in this proposal seeks to change existing arrangements. The proposals do not facilitate additional borrowing over what is already permitted within the capital regulatory system. The existing arrangements with the Government retaining ultimate regulatory control are to be maintained and borrowing authorities will be required to operate within the current prudential code. What it will do is, for any given level of borrowing, reduce the interest bill local taxpayers have to fund.

Is it legal for councils to guarantee each other’s debts?

Our very clear legal advice is that the General Power of Competence (GPC) introduced in the Localism Act 2011 gives English councils the power to do this. Because the GPC does not cover other public bodies such as Police, Fire and National Park Authorities, it is less clear whether they could do the same without a change in the legislation, which applies to them.

Should councils be concerned about providing a joint and several guarantee?

The Agency will have in place a credit process, underpinned by ongoing monitoring; risk and liquidity capital; and a right of recourse, which will ensure, in the event of the guarantee being called, that it will be applied proportionally. Even were the guarantee to be called, creditors would be confident of receiving their money back in time. The protections available would be stronger than currently apply in the case of inter-council lending. Nevertheless, no local authority has ever defaulted and for the joint and several guarantee to be called an unprecedented situation would have arisen.

What controls are in place to prevent a default and what measures are available to a council to recover sums owing to it?

There are a range of controls designed to prevent a Local Authority from defaulting on its obligations. In addition, there are legislative measures that are likely to ensure that even if a Local Authority does default, its creditors are able to recover sums owing to them. These controls and measures include:

- *Councils are statutorily prevented from borrowing to avoid raising taxes and cutting spending, thereby reducing the risk of a council entering financial distress.*
- *The prudential code forces councils to consider whether borrowing is affordable and financially sustainable.*
- *The responsibility of Section 151 officers under Section 114 of the Local Government Finance Act 1988 to ensure that councils can meet their obligations as they fall due, and to formally report if the council's expenditure will exceed its resources.*
- *Continuing access to the PWLB for liquidity support.*
- *Government reserve powers to intervene. To date, the Government has not allowed any Local Authority to default on its obligations.*
- *If a Local Authority defaults on a debt greater than £10,000 for a period of two months, under Section 13(5) of the Local Government Act 2003 a creditor may apply to the High Court for an administrator to be appointed. This process should ensure that any Local Authority that is called upon under the guarantee can recover the debt via the courts if need be. The powers of the administrator will be determined by the High Court, but can include:*
 - *Collecting, receiving or recovering the revenues of the local authority*
 - *Issuing levies or precepts; or*
 - *Setting, collecting or recovering Council Tax.*

What is the reaction of local authorities to the establishment of an agency?

A significant number of local authorities have been very supportive of the initiative to date, devoting time and resources to help ensure that the business case is fully robust. As part of the business case review, we carried out a survey of English councils and, in addition, presented at a number of local authority conferences. Since publishing the revised business case we have spoken directly to over 90 councils. These recent conversations, the survey, and conference feedback, have confirmed to us that there is significant demand for an alternative, local authority controlled, source of capital finance

How much will it cost?

We are looking to raise £8 to £10 million capital, which includes a buffer to ensure that the agency is well capitalised. Our project plans envisage that this will be used within a staged process, with a number of checkpoints overseen by a rigorous governance process. We have established the Local Capital Finance Company Ltd and have now presented a firm investment proposition to all councils and related bodies, such as local authority pension funds, in an Information Memorandum.

Haven't local authorities stopped borrowing money and therefore will there be a sufficient volume to support the agency's business plan?

It is correct that volumes of local authority borrowing have reduced recently. There are a number of reasons for this: low interest rates have resulted in councils doing more short term borrowing from each other; many councils have a legacy of long dated debt overhang and LOBO structures; and councils have reduced capital spending, partly driven by reduced headroom on their revenue accounts and recent austerity measures. However, discussions with councils reveal significant future demand for borrowing, which will be required for: local enterprise partnerships, city deals, town centre rejuvenation projects, roads, housing, schools and simply to maintain the nation's capital stock. The maintenance backlog on local roads alone now stands at £12 billion.

Will the Agency require councils to undergo a credit process?

Yes. Providers of finance, be they bond market investors, banks or non-bank providers of credit will expect a credit process to have been undertaken. The credit process will underpin the agency's credit rating, thus enabling it to achieve the keenest rates of interest. The credit process will be tailored to councils and the Agency and will not be excessively onerous.

Will borrowers have to pay interest rates higher than PWLB interest rates?

We cannot foresee circumstances when this would occur. Section 8 (page 53) of the business case sets out the pricing strategy, which is driven by the need for the Agency to deliver savings to its local authority borrowers. It can be found at this [link](#):