Post PWLB Rate Change Borrowing Strategy

1. Background

1.1. On 9 October, the Public Works Loan Board (PWLB) increased the cost of borrowing for local authorities by 1% for any new borrowing bringing the total borrowing rate to gilts +1.8%. This increase has made the cost of servicing the debt associated with the Council's capital programme more expensive, creating an additional budget requirement for interest costs which has been factored in the MTFS. This has also impacted on capital schemes which are 'self funding' (i.e. those that generate income or savings which offset capital financing costs), by meaning such schemes have a higher bar they must meet before being financially viable.

1.2. The Council's borrowing strategy previously had been to source the majority (approximately 70%) of new borrowing from the PWLB, with the remainder coming from borrowing from other Local Authorities. This must now be reviewed in line with the change.

2. Alternatives to PWLB

2.1. The Council's treasury management strategy permits borrowing from a number of sources: however it was not anticipated that any alternatives to PWLB would be utilised given the low cost of PWLB funding previously. One other key attraction of PWLB was the low administration cost associated with raising funding, which was done by a simple phone call from officers when new borrowing was arranged.

2.2. Alternatives to PWLB will bring with them a significantly elevated resourcing requirement for Haringey officers, and will be far more costly administratively.

2.3. The alternatives to PWLB and borrowing from other local authorities could include:

- UK registered banks and building societies
- Pension Fund investors (both private and public sector)
- Other bond investors
- The Municipal Bonds Agency PLC (yet to issue any bonds)

2.4. Discussions with high street banks suggest that the Council would only be able to raise borrowing for up to 7 years in duration at rates which compare favourably to PWLB. This is too short a duration for this to form a major component of Haringey's revised borrowing strategy, where the majority of funds borrowed will be in excess of 20 years. However, this will likely be reviewed by the sector generally, as banks may see local authority lending as an opportunity following the announcements.

2.5. Initial discussions, have suggested that the Council may be able to borrow from institutional investors at rates of around gilts +1.2-1.8% or lower for periods of over 20 years, via Private Placement Agreement (PPA). Such arrangements will be subject to negotiations with the lenders, who will need to do due diligence on the Councils borrowing funds. The process of entering into such agreements will be administratively complex, and such agreements would typically be around £50m in size (i.e. the Council would need to do multiple deals to fulfil its borrowing requirement, potentially several per year). Councils who have stronger balance sheets and larger levels of reserves will be able to negotiate better rates. Lenders will prefer to lend funds on variable interest rates, as pension funds prefer investments with inflation linked yields to match their inflation linked liabilities.

2.6. A bond release would first require the Council to become credit rated by one (or more) of the major ratings agencies, which is an involved, lengthy and costly process. A handful of authorities have gone down this route, some not having completed the process, having found that they would have been unable to access funds at a lower rate than the previous PWLB rate of gilts + 0.8%. It is thought likely that investors will lend to local authorities at rates less than the new PWLB rates of gilts +1.8%, and, potentially at rates lower than those available via PPAs. However the precise rate offered will be dependent on the specifics of the financial strength of the authority. Some Councils who have released bonds recently have done so at a variable rate linked to inflation, which is not anticipated to be appropriate to fund most, if not all, of Haringey's capital programme. Councils who have large reserves, and a history of underspending on revenue budgets will be able secure the best rates. Bond releases typically require a minimum size of at least £200m.

2.7. Currently, the market which provides alternative funding to the PWLB for local authorities is not well developed. Only a handful of authorities have raised funds via alternative routes, as PWLB rates have previously been at levels that competitors could not offer. This is now likely to change, and the market is likely to reassess the possibility of lending to Councils. The Council's borrowing strategy will therefore have to be agile in coming years, as developments that present opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this.

2.8. Whereas previously the 'benchmark' was gilts + 0.8% which competitors had to beat to be attractive to Councils, the 'benchmark' has now moved upwards to gilts + 1.8%. There is a risk that the market will increase pricing for funding to just below this new benchmark, for example, a lender who had previously been willing to lend to Councils at gilts +1.2% could now increase their offer to gilts +1.7%: just below the new PWLB rate. This pricing risk will prevail until it becomes clear that the market for alternatives to PWLB is so developed that lenders have to offer significant discounts to the PWLB benchmark rate in an attempt to compete with one another. It is unclear at this stage whether this level of competition will ever materialise, and it is likely to take some time to do so.

2.9. What is clear is that alternatives to the PWLB will require far more involved due diligence processes, borrowing will likely have to be done in large tranches, rather than taking small amounts incrementally, as was common practice from the PWLB, and rates offered will differ depending on the financial position of individual authorities.

3. Considerations going forwards

3.1. Officers will continue to explore alternatives to the PWLB, working with the Council's treasury advisor, Arlingclose. PWLB rates will also be kept under regular and active review, as future drops in gilt rates may provide advantageous borrowing rates for the council (even with the additional PWLB margin applied).

3.2. There is also a possibility that the PWLB will renege on the increased rate that has been put in place, or indeed offer lower rates for projects such as house building for example. Should this occur, the borrowing strategy will require further revision/review.

3.3. The Council's immediate borrowing needs can be fulfilled by borrowing from other Local Authorities in the short term, this is consistent with the Council's approved treasury management strategy.

3.4. Officers will report back regularly to the corporate committee on this topic to keep them updated on developments.