

Members Briefing Note

11th October 2019 (updated Jan 2020)

PWLB Increases Loan Margin

The Public Works Loan Board has increased the margin applied to loan rates as of 9th October 2019 from 80bps (0.8%) to 180bps (1.8%). HM Treasury cite the substantial increase in use of PWLB loans at some authorities as the cost of borrowing has fallen. Many authorities have used the funds to invest in commercial property to produce financial returns to invest in services. MHCLG expressed concern about local authorities acting in this way back in April 2018 by issuing revised guidance for Local Authority Investments. The drop in gilt yields during 2019 only improved the margin achievable by these commercial activities prompting record levels of new borrowing through the PWLB with £1.9billion new borrowing undertaken in August.

The key considerations on the impact of the policy for the council are discussed below.

Future Funding

Borrowing long-term from the PWLB is now considerably more expensive. The movement in rates on maturity loans is shown in the table below. Reactions in the inter-authority market, which provides short-term borrowing, have been volatile but the short-term spike in rates is expected to settle. The ability to borrow from institutional investors is expected to prevent the full impact of the 1% increase being passed on to the market.

Period	Mar-18	Sep-18	Mar-19	Aug-19	Oct-19
1 year	1.67	1.75	1.68	1.44	2.61
5 year	2.09	2.18	1.77	1.28	2.42
10 year	2.46	2.57	2.09	1.44	2.60
20 year	2.75	2.91	2.56	1.96	3.10

Financial Strength Ratings

Market alternatives to PWLB are currently available however unlike borrowing from the PWLB, there is significant scrutiny from investors. This may cause notable differences in interest rates between “strong” and “weak” authorities and balance sheet management will be paramount to achieving favourable rates. The rating agencies are likely to comment on the increase in interest cost across the Local Authority space however it is unclear whether this will influence the outlook or credit rating for the few rated authorities.

Future Policy Change

The lobbying back in 2010 had limited effect on the margin change so it is not expected for this policy to be reversed in the short term. Treasury will keep the rate policy under review so with talks of a general election, a change in government could bring about another policy development.

Brent's Funding Requirements

The council has a borrowing requirement of £230m over the next 5 years. The 1% increase in interest rate will cost an additional £2.3m per annum. Financial appraisals for the capital programme during 2018 were calculated using a 4% interest rate. This means there was headroom already built in and

the change in policy is not expected to have a serious impact on the programme's viability. The rate rise does however make future capital appraisals more challenging.

There are alternative options to using PWLB to fund our borrowing requirement which are summarised below:

Short Term	Long Term
<p data-bbox="114 97 331 124">Cash Balances</p> <ul data-bbox="174 132 1043 643" style="list-style-type: none"> <li data-bbox="174 132 1043 228">• In recent years the council has deliberately chosen to utilise cash reserves, balances and cash flow in lieu of actual borrowing. <li data-bbox="174 236 1043 403">• In simple terms this means that the Council has forgone interest income (which is historically low) whilst at the same time saving interest payable on borrowing. This strategy has resulted in approximately £5m capital financing costs being avoided for several years. <li data-bbox="174 411 1043 507">• There is nothing unusual in this, Councils across the country have been utilising cash balances to finance capital investment and many are now having to borrow as balances run down. <li data-bbox="174 515 1043 643">• Current interest rate forecasts along with the significant levels of planned capital investment over the next three years means that this approach is no longer sustainable and we anticipate a borrowing need within 12 – 24 months. 	<p data-bbox="1055 97 1323 124">Forward Borrowing</p> <ul data-bbox="1115 132 2101 922" style="list-style-type: none"> <li data-bbox="1115 132 2101 268">• Following the comprehensive borrowing strategy endorsed by Cabinet in Sep 2018 officers have been working with our treasury advisors for the last 6-8 months to secure borrowing from private institutions and expect to be in a position to lock in competitive terms in 2020. <li data-bbox="1115 276 2101 303">• Part of this work includes the consideration of forward borrowing. <li data-bbox="1115 311 2101 371">• Forward starting loans are agreed in advance of need, at a fixed rate for delivery on a pre-determined future date. <li data-bbox="1115 379 2101 440">• Although there is a much longer lead time compared to PWLB they do therefore offer greater flexibility. <li data-bbox="1115 448 2101 539">• A number of institutions currently offer these loans to Councils including commercial investors and recently the European Investment Bank (EIB). <li data-bbox="1115 547 2101 683">• A major advantage of forward loans is that by agreeing to a fixed rate now for future delivery (up to 5 years) the Council is able to hedge future interest rate exposure whilst avoiding a short term increase in costs, as interest payments do not commence until the loan starts. <li data-bbox="1115 691 2101 818">• Furthermore, with recent announcements concerning the PWLB 1% rate rise there is an expectation that private sector lenders that would previously have lent at 0.2% to 0.5% above PWLB rates will now lend at 0.8% to 0.5% below the new rates. (subject to credit quality). <li data-bbox="1115 826 2101 922">• As Brent are already significantly advanced in this process we are in an ideal position to take advantage of this before the market reacts and expect to be in a position to agree sometime during 2020.
<p data-bbox="114 963 439 991">Local Authority Lending</p> <ul data-bbox="174 999 1043 1406" style="list-style-type: none"> <li data-bbox="174 999 1043 1126">• There is an active council to council short term lending market, that offers short term rates generally lower than PWLB. This is seen as a low risk strategy and is “mutually beneficial” for both lending and borrowing councils. <li data-bbox="174 1134 1043 1230">• This is because lenders should benefit from the higher credit quality that local authorities offer, while borrowers get a rate preferable to other sources like the PWLB. <li data-bbox="174 1238 1043 1406">• However, this generally applies to short term funding (1 - 2 years) which obviously carries re-financing risk. With the levels of cash balances held the council has not needed to utilise LA borrowing recently however this does remain a short term option. 	<p data-bbox="1055 963 1379 991">Municipal Bond Agency</p> <ul data-bbox="1115 999 2101 1374" style="list-style-type: none"> <li data-bbox="1115 999 2101 1094">• The agency’s purpose is to raise finance for local government at a lower rate than the individual authorities could raise finance from the PWLB. <li data-bbox="1115 1102 2101 1230">• The agency, which launched five years ago, has yet to raise its first bond due to low rival rates offered by the Public Works Loan Board and concerns over the “joint and several guarantee” which would see participants share responsibility for any defaults by borrowers. <li data-bbox="1115 1238 2101 1299">• However, as the margin above gilts for PWLB loans has increased, the market has shifted in the agency’s favour. <li data-bbox="1115 1307 2101 1374">• Treasury officers are actively looking at what steps would be required to raise funding from the MBA.