UK MUNICIPAL BONDS AGENCY

Q&As UK MBA

1.0 The rationale and history of the UK municipal bond agency

Why launch a municipal bond agency?

- The agency will be an independent company owned by local government with the primary aim of reducing financing costs for councils through sourcing funding at competitive interest rates

- The agency will allow local authorities to diversify funding sources and borrow at lower cost

- The agency will be a visible demonstration of the credit worthiness of local authorities and both increase the number of investors lending to the sector and make it easier for them to do so

- There are precedents evidencing the positive impact of municipal bonds agencies in other countries – such as the Nordic region. Their success in reducing the borrowing costs of local authorities has encouraged the establishment of agencies in other countries, such as Agence France Locale in France

Why has there not been a municipal bond agency previously in the UK?

- Sources of UK local authority borrowing have varied over the years, in the 1980's individual local authorities did issue bonds directly

- Funding for local authorities has, in the recent past, mainly been through the Public Work Loans Board (PWLB)/ Debt Management Office (DMO), which increased rates in 2011

- The Local Government Association's ability to bring local authorities together has been a major driver behind this initiative

- The success of municipal bonds agencies in the Nordic countries provides a powerful precedent for launching an agency in the UK

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

- No. Councils have the necessary powers

What's the potential size of the UK municipal bond market?

- Local authority long term borrowing in Mar 2013 was £84.5 billion. ~75% of this was through the PWLB/ DMO
- The agency should, over time, capture a significant market share, by providing more competitively priced lending

2.0 About the UK Municipal Bond Agency

How much will it cost to run the UK MBA? How long will it take to break even? Who will pay for this?

- It will cost less than £2million per year to run the UK MBA. The UK MBA will be run effectively and efficiently, while maintaining robust processes and management.
- The UK MBA will be paid for in an additional 10bps premium on the cost of debt issuance shareholders and 15bps for non-shareholders. This will be reviewed over time
- The agency should reach break-even when it reaches £2billion in lending volume, which is anticipated within the three years
- Local authorities shareholders are providing the capital required to reach that point
- Our project plans envisage that this will be used within a staged process, with a number of checkpoints overseen by a rigorous governance process

How many people work for the UK MBA?

- The UK MBA is run as a lean operation. We have only five full time staff, and we do not envisage becoming significantly larger

What is the background of the UK MBA staff?

- The UK MBA staff come from a diverse and complementary range of backgrounds in finance and local government

What is the composition of the UK MBA Board of Directors?

- The UK MBA has constructed a heavyweight board with proven and complementary experience and expertise across local government, central government and capital debt markets.

3.0 Timelines for the launch of the UK MBA/ First Issue

When does the agency expect to launch its first bond?

- We are currently busy putting in place the required processes and structure to create a successful, long-term issuing programme for UK municipal bonds. We will be making further announcements on our progress in due course.

Can you give us a timeline of when the above may be completed?

- The process is ongoing, but we will only launch when the councils are ready to do so
- Experience has shown it is more important to get the first bond issue right, than to get it out quickly (the proof is AFL – the French agency who had a very successful first bond issue following extensive consultation)

What price are you looking to achieve on the first issue?

- The final price will depend on the exact nature of the issue and market conditions at the time. As we've stated, we believe that UK MBA bonds will be highly attractive to investors

What size issue do you want to achieve with your first issue?

- Clearly we want to achieve a good sized issue with a diversity of councils involved

How many councils do you expect to be involved with your first issue?

- Our aspiration is to have a decent number of councils on the first issue, but this depends on the councils specific funding needs at the time of the first issue

What maturity do you expect the first issue to be?

- This depends very much on the exact needs of councils and the market at the time, but we would anticipate that the first issue be a medium term issue

4.0 UK MBA Shareholders

How many local authorities have signed up to supporting the UK MBA?

- 56 have signed up to provide the capital required to launch the UK MBA

These councils represent a broad spread across all regions, tiers and political control in local government

- There is significant demand for an alternative, local authority controlled, source of capital finance

- 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

- We continue to engage with local authorities throughout the UK, including future potential shareholders. Our aspiration is, over time, for every UK local authority to become a shareholder

How much capital has been invested in the UK MBA?

- To date £6m has been raised from councils (& LGA) to launch the UK MBA. (It's important to note that this is to set up and run the agency – the agency is not a bank and will not lend its own capital.).

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 shareholders, while delivering economic benefits to borrowers

- Its aim 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

5.0 UK MBA Borrowers

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 robust credit process, leveraging the Agency's expertise, will be tailored to councils and the Agency and will not be excessively onerous

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

- We cannot foresee circumstances when this would occur

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

What can local authorities use the money for?

- Local authorities can only borrow for capital purposes or refinancing. Specific projects will depend on each local authority, but we would anticipate funding being sought for schools, housing, town centre developments, transport and other infrastructure projects required to support local communities and economic development

- Volumes of local authority borrowing have reduced recently, and 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 demand for borrowing

What will be the impact on local government borrowing costs?

- Currently local authorities borrow from the PWLB/ DMO, predominantly at a rate of 80 bps above gilt rates, for the majority of their borrowing requirements

- We expect the agency to be able to deliver significant savings on borrowing costs

- The larger, more liquid issues that the municipal bond agency would create are more attractive to investors

6.0 UK MBA Investors

Who are likely to be the UK MBA's investors?

- Any investor who wants to buy high quality sterling paper.

What bond rating does the UK MBA expect to get?

- We believe that the agency will receive an attractive rating that reflects the credit strength of UK councils and the joint and several guarantee

- The exact rating is a decision for the credit agencies

Who will underwrite the municipal bonds if local authorities default on them?

- The agency will benefit from a joint and several guarantee of the borrowers

- The risk of default is very low, with no UK local authority ever having defaulted

- Local authorities (and their financial officers) are subject to statutory controls to protect against the risk of default, for example the Prudential Code and the need to have a balanced annual revenue budget

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 o Issuing levies or precepts; or
- Setting, collecting or recovering Council Tax

- In addition, the Agency will have a robust liquidly process

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

- Council opinion, obtained by the Local Government Association, confirms that the General Power of Competence (GPC) introduced in the Localism Act 2011 gives English councils the power to guarantee each other's' debts

- 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

7.0 The impact of the UK MBA on Government

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

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."