Municipal Bonds Agency

Update

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27 Feb 2014

What is a Municipal Bonds Agency?

Freestanding independent body established and owned by Local Government sector to issue bonds on its behalf and on-lend the proceeds

It will raise funds from capital markets at regular intervals to on-lend to participating authorities

It will be credit rated by at least two credit rating agencies with an objective of triple-A

Background

2011	2012	2013
March **Following** PWLB raising interest rate to 1% above gilts (Oct 2010). LGA establish a Task & Finish Group to explore creating an LA collective agency to raise and on-lend funds	**January** Outline Business Case published **November** PWLB introduce certainty rate at 0.8% above gilts	**July** LGA conference launches *Rewiring Public Services*: 'recreating a thriving market in municipal bonds' one of ten big ideas **Sept-Nov** Phase one of project to seek council support 1 Nov PWLB introduce project rate (0.6% above gilts)

Current Activity

2013

Sep – Nov Regenerated project, garnered sufficient support to justify investing in business case re-validation

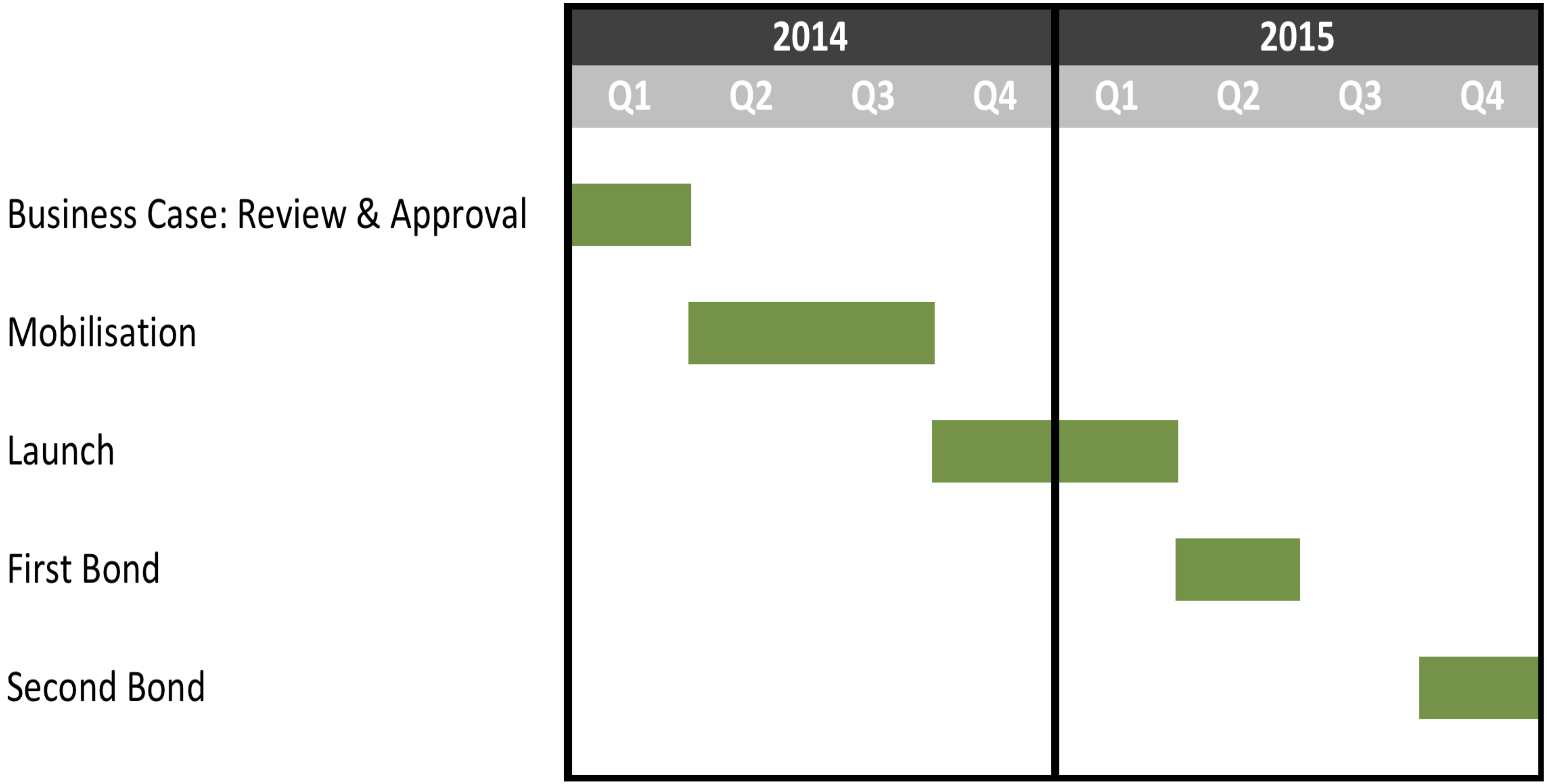
Dec Recruited Lead and Strategic Advisers

2014

Jan – Mar Revalidation/revision of business case

19/20 Mar – Decision on next steps

Target Establishment Timeline



Note: As part of the review process, we are examining the feasibility of an earlier Bond issue

Work to revise business case

Council demand

- Surveyed 132 councils, 49 responses
- 39 interested and with borrowing needs
- £4.9bn potential volume identified over next 3 years

Banks

- Discussions held with 6 banks (Barclays, RBS, Deutsche, HSBC, Lloyds & Goldman Sachs)

Ratings Agencies

- Discussions held with Moody’s, Fitch and S&P

Other

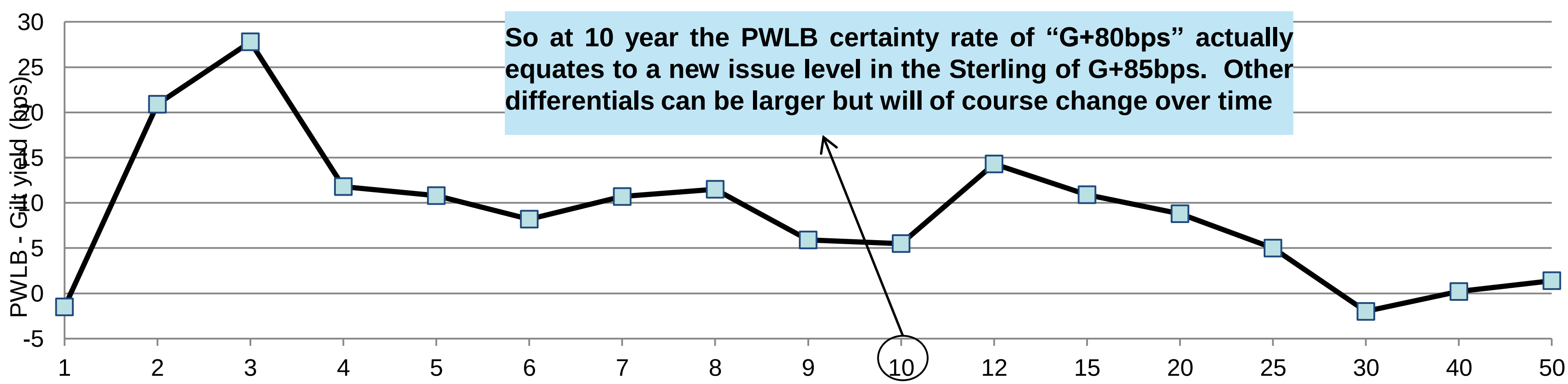
- Legal – discussions with Allen & Overy on bond structure and other legal advice on vires
- Regulatory - on hold
- Governance and Capital structure discussed at both officer & political level

PWLB vs. Gilt yield curve

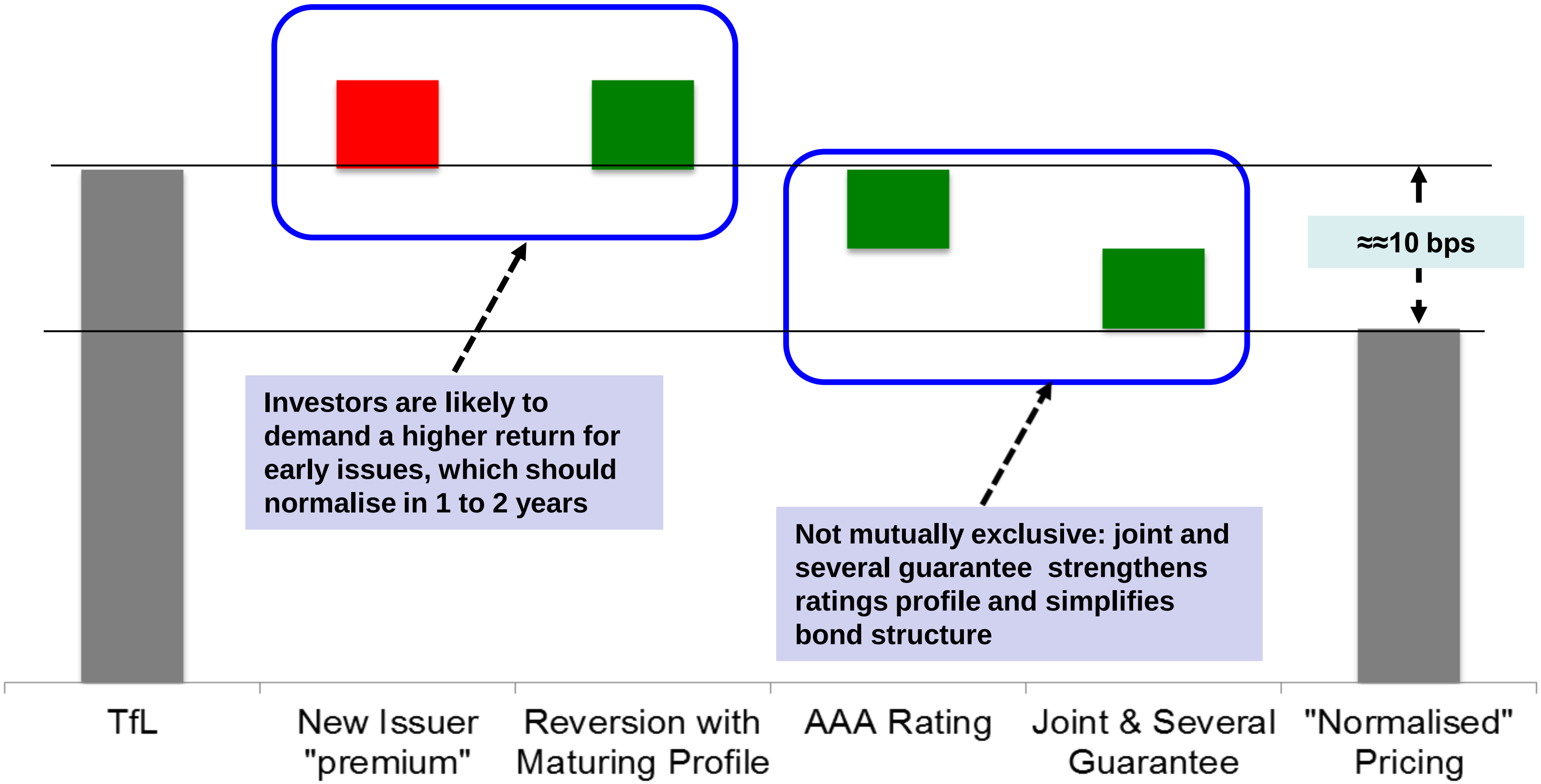
There is a mismatch between the much quoted "G+80bps" of the PWLB certainty rate and the reality of how that translates to new bond issuance quoted against the UK Gilt curve

- It is important to focus on exactly what the "G+80bps" PWLB rate really means when compared with public bond market pricing
- The chart below illustrates the mismatch at various parts of the curve between PWLB and underlying Gilt rates

PWLB vs. Gilt curve mismatch



Bond Pricing - Illustrative

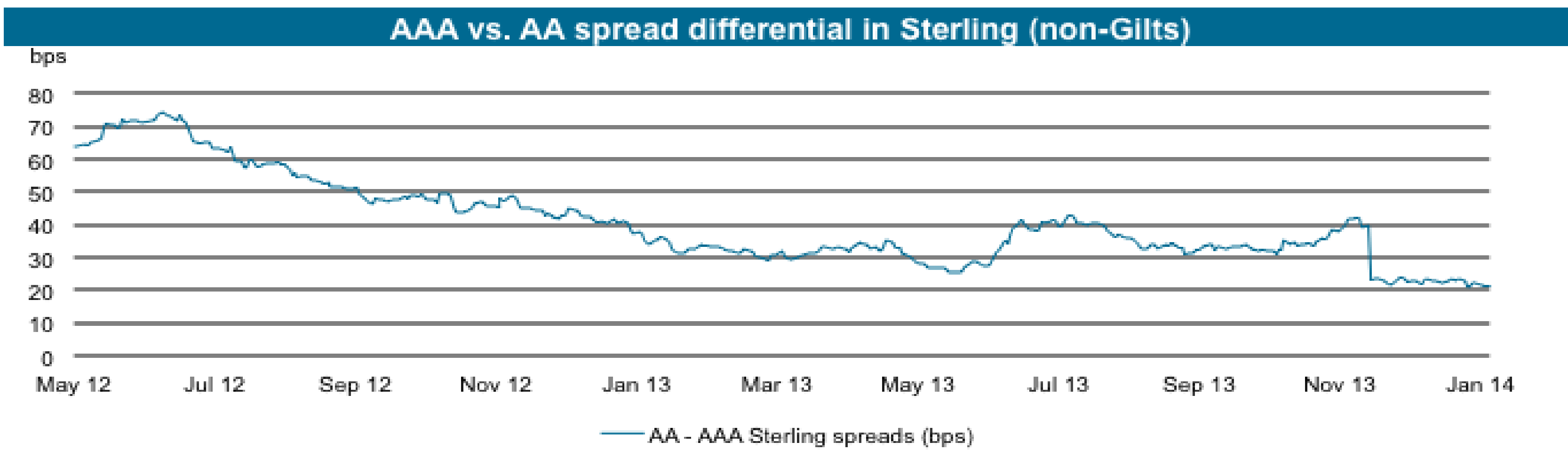


Note: Estimate. Non-Gilt AAA vs. AA spread differential is ~20bps. Cambridge University (AAA) bond priced at 60bps over Gilts, when TfL (AA) preceding bond priced at 88bps over Gilts and subsequent bond priced at 70bp over Gilts. Nevertheless, TfL bonds generally price very strongly, so significant premium will be difficult to achieve and depend upon equivalent quality of execution.

Impact of credit rating

Any Local Authority bond vehicle will maximise its potential spread outcome by achieving a Triple A rating

- **The enhancement of the credit rating associated with any LGA linked issuance vehicle would play a key role in ensuring the tightest possible spread outcome for any new bond issuance**
- **The chart below shows the differential between Triple A and Double A spreads in the Sterling market (excluding Gilts)**
  - **The differential has been falling (from as much as 70bps in June 2012)**
  - **The differential has been relatively stable at 20bps in recent weeks**
- **Much of the detailed pricing debate around any new issuance from an MBA vehicle will come down simply to where the likes of TfL and GLA are trading at the time**
  - **That said, the key way to minimise the new issue premium charged to these more established borrowers is to maximise the credit rating**
  - **The way in which the higher credit rating is obtained will also be important. If investors can see a real liquidity buffer in place to cover a certain coupon payments or protect against the default of a portion of the borrowing entities then this will only help GLA's relative value arguments**



Loan Pricing: Assuming TfL Bond rates

	Indicative Borrower Economics - Cost of Risk Capital				
Maturity Loan (Years)	30	20	15	10	5
Loan Size	100,000,000	100,000,000	100,000,000	100,000,000	100,000,000
Public Works Loan Board ("PWLB")					
Market Gilt Rate	3.54%	3.35%	3.13%	2.78%	1.68%
PWLB incremental	-0.02%	0.09%	0.11%	0.06%	0.11%
PWLB Margin	0.80%	0.80%	0.80%	0.80%	0.80%
PWLB Pricing	4.32%	4.24%	4.04%	3.64%	2.59%
Municipal Bonds Agency ("MBA")					
Market Gilt Rate	3.54%	3.35%	3.13%	2.78%	1.68%
Syndicate fees	0.02%	0.02%	0.02%	0.02%	0.03%
Administration / Ratngs Fees	0.02%	0.02%	0.02%	0.02%	0.02%
Capital Costs	0.03%	0.03%	0.03%	0.03%	0.03%
MBA Operating Costs	0.10%	0.10%	0.10%	0.10%	0.10%
Margin over Gilts	0.58%	0.58%	0.58%	0.58%	0.58%
MBA Pricing	4.29%	4.10%	3.88%	3.53%	2.44%
Difference	0.03%	0.14%	0.16%	0.10%	0.15%
Annual Saving	27,980	136,125	158,807	102,235	150,900
Total Saving	839,400	2,722,500	2,382,100	1,022,350	754,500

1) PWLB Rates: ~98% of loans at Certainty Rate, PWLB incremental due to Yield Curve used and varies day to day. (Example as at 17 January, 2014)
2) Impact of MBA Operating Costs may reduce over time as volumes permit
3) Margin over Gilts based on latest TfL Bond Issue, in Q4 2013
4) Early issues likely to be in 15 to 30 year maturities

Joint & Several Guarantee

Discussions with Banks suggest a significant pricing advantage from Joint & Several Guarantees

Strengthens Ratings Agency discussion

Simplifies Bond Structure / eliminates significant execution risk

We have a legal opinion supporting the vires aspects of English councils giving such Guarantees under the General Power of Competence

Guarantor Protections (Subject to Legal Opinion)

Prudential Code	Requirement for Balanced Budget
PWLB	Local Government will retain access to PWLB
Agency Process	Credit, Liquidity and Risk Capital
Default	High Court process in the event of default
Proportionality	Right of Recourse

Capital Structure

Proposed revisions to original business case, which envisaged these being funded by Subordinated Debt:

Operating Capital – Provisional estimate £8 to £10 million required:

To be funded by Common Equity, with a dividend policy to reflect preference for annual return to investors

Advantage of approach: Reduces execution risk and aligns economic interests in the Agency with level of investment

Risk Capital – Assumption for Business Case of 3 to 5% requirement, considered prudent

To be funded by 'over-borrows' from the agency

Advantage of approach: Reduces risk from funding mismatches and is materially cheaper

Further work required:

Confirm technical / accounting treatment

Proposed Governance structure

Phase	Governance Structure / Transitional Arrangements
Business Case	As is
Mobilisation	CFO and Political Groups retain advisory function Project Board established by LGA: Includes LG Finance Directors Control of project remains with LGA Initial Board of Directors selected
Launch	Board of Directors 3, including Chair, voted by Shareholders 2 Technical Experts: Risk, Debt Capital Markets 2 LG Finance Directors Technical Experts & Finance Directors selected by LGA

Questions?