Taunton Deane Borough Council

Tenant Services Management Board – 19 September 2011

Housing Revenue Account Reform Project – Borrowing Options

Report of the Strategic Finance Officer

1. Executive Summary

1.1 The HRA through the Localism Bill will move to a system of "self-financing"

1.2 There will be a need to borrow a significant sum to "buy" ourselves out of the current system.

1.3 This report gives details of the various options open to TDBC to borrow funds for the HRA.

2 Background

2.1 The Localism Bill includes a move to a system of "self-financing" for the Housing Revenue Account (HRA)

2.2 TDBC will have to "buy" its way out of the current system in which we pay negative subsidy to the Government of approximately £7m. To do this TDBC will have to pay in excess of £87m to the Government.

2.3 TDBC does not have £87m in its reserves or bank account to do this. The only option is to borrow the funds to pay the Government.

3 Borrowing Options

3.1 There are many options for borrowing the £87m. The various options are described below. The pros and cons for each option are given in appendix A.

3.2 Internal Resources
This is using funds that TDBC holds in reserves. It is cheaper to do this as borrowing costs are currently higher than the returns on investing our money. We would need to ensure that if these reserves were used they were not required in the short to medium term. If General Fund reserves were used we would need to establish a reasonable rate of interest that was equal to or below the cost of external funds that the HRA and a method of allocating these costs between the HRA and General Fund would need to be established.

3.3 Public Works Loan Board (PWLB)

The PWLB is a statutory body operating within the UK Debt Management Office and is responsible for lending money to local authorities and other prescribed bodies, as well as for collecting the repayments. Following the Comprehensive Spending Review the cost of borrowing from the PWLB rose to gilts + 100 basis points (1%). The PWLB is relatively easy to borrow from, is flexible and still competitive when compared to bank lending..

3.4 Local Authority Loans

This is borrowing and lending between local authorities. Those authorities with money to invest lend money to other authorities. The rates are greater for the lenders than they would get in the market and lesser for the borrower than the open market. It is however expected that following the many HRA payments to Government and the effect of grant cuts continue to be felt there will be far less funds available from this source which would in turn increase the interest rates.

3.5 Short Term Loans

Commercial Paper - Commercial paper is a money market security issued (sold) by large banks and corporations to get money to meet short term debt obligations and is only backed by a promise to pay the amount on the maturity date specified on the note. As it is not backed by collateral, only those with an excellent credit rating will be able to sell their commercial paper at a reasonable price. The main characteristics of commercial paper are:

- It is unsecured.
- It is short term borrowing instrument (maturity and full repayment usually within a year of issue).
- It is usually less liquid than bonds - there is no real secondary market

<u>This market is not yet readily available to local authorities although it is expected that a market will evolve as we get nearer to the self financing settlement date.</u>

3.6 Bonds

Private Placement – This is like a bi-lateral loan agreement (could be a pension fund) and would be for amounts in excess of £50m.

Club Issue – This is where a group of borrowers form a club to go to market once to borrow for all within the club, hopefully benefiting from lower interest rates. This is complex from both sides and some investors do not like clubs. There is a lot of admin involved in setting up the club and bond. The rates may not beat the PWLB rates. This was a popular method of raising finance in the 1980’s.

Public Issue – This is an issue on the market and is normally for in excess of £150m and therefore is not open to TDBC.

3.7 Bank Loans

LOBO - LOBO stands for Lender Option Borrower Option. It is typically very long-term - for example 40 to 60 years - and the interest rate is fixed.

However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates, such as every 5 years. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the ‘option’ to either accept the new imposed fixed rate or repay the loan facility. There is a loss of flexibility with LOBO loans and in most cases interest rates will only rise in the long term.

Bank Facilities – since the credit crisis banks have had to look after their balance sheets. Where significant long term loans are made there must be a provision on the balance sheet for any default. This charge is passed onto the borrower and the rates are therefore not attractive as they are higher than the PWLB. There are limited number of banks that may be able to offer rates less than the PWLB but these will be short term loans 1-5 yrs.

4 Rates of Borrowing

4.1 The rates of interest that will be payable on any loan does depend upon many factors such as length of the loan, amount of the loan and the source of borrowing.

4.2 The borrowing rates within this report show gilts plus a number of basis points (100th of 1 percent).

4.3 A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. In exchange for lending the Government money interest is paid to the lender. It is this interest rate that is used as a base in any of the borrowing rates mentioned in this report.

4.4 PWLB fixed interest rates are based on gilt yields, and are published twice a day, at 9:30am, for start of business, and 12:30pm. Variable interest rates are determined at about 11 a.m. each day and are based on the general collateral repo rates for one, three and six months, as appropriate, as fixed by the British Bankers' Association on the day.

4.5 Many things affect the gilt yields including, inflation assumptions and other market assumptions along with actual figures when published such as growth figures.

4.6 The Greater London Authority issues a bond recently for £600m. The rate of interest on this bond was gilts + 80 basis points with a cost of 3 basis points, therefore a saving of 0.17% on PWLB rates. Given the size of bond we may issue on our own, or an issue as a club (leading to a greater interest rate payable) any issue would probably not beat the PWLB rate (when including costs such as legal costs and the need to have a least one credit rating).

5 Recommendations

5.1 Members are asked to note the contents of this report.

Option	**Pros**	**Cons**	**Recommendation**
Internal Resources	Cheap as we do not have to pay borrowing costs No credit rating required	Loss of investment income Some reserves are earmarked and needed in the short term Other reserves may be needed at short notice Internal resources will not provide the full funding requirement.	Could persue this option for a small % of borrowing requirment
PWLB	Relatively easy to borrow from Flexible More competative than bank lending but potentially more expensive than bond finance. PWLB has offered a flexible borrowing option for the 1st year of the borrowing requirment	Following the CSR borrowing from PWLB is more expensive	Still an attractive borrowing option
Local Authority Loans	Borrowing costs less than the market Credit ratings not required	Following HRA reform payments it is expected that there will be less funds available Quite often this is short term borrowing option.	Pursue for the short term funding requirment if a source can be found
Short Term Loans	More competative than banks	Credit rating required Short term only	Could persue this option as long as the rate offered is attractive taking into account the need for a credit rating.
Bonds - private placement	Could be cheaper than PWLB	Usually for around £50m minimum	Not to persue this option
Bonds - Club issue	Could be cheaper than PWLB	Credit rating required Very complex to set up	Not to persue this option
Bonds - Public issue	Could be cheaper than PWLB	Credit rating required Normally for over £150m	Not to persue this option
Bank Loan	Easy to set up	Expensive following banking crisis Loss of control with LOBO	Not to persue this option